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CEYLON CURRENCY AND BANKING

BY

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WITH A FOREWORD

BY

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LONGMANS, GREEN & CO. LTD.

LONDON - NEW YORK - TORONTO

BOMBAY - CALCUTTA - MADRAS

1941

LONGMANS, GREEN AND CO. LTD.

39 PATERNOSTER ROW, LONDON, E.C.4

17 CHITTARANJAN AVENUE, CALCUTTA

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LONGMANS, GREEN AND CO.

114 FIFTH AVENUE, NEW YORK

221 EAST 20TH STREET, CHICAGO

88 TREMONT STREET, BOSTON

LONGMANS, GREEN AND CO.

215 VICTORIA STREET, TORONTO

FOREWORD

THE monetary affairs of British India have in recent years received abundant attention and the rupee has been among the most canvassed currencies in the world. In comparison with these prolonged studies, the monetary history of Ceylon has received little notice. Yet Ceylon currency has a tale worth telling. In its own miniature way it reflects most of the phases of thought that mankind has devoted to the problem of the unit of value and there is much benefit to be derived from an examination of the various avatars which Ceylon money has assumed at different times from the early days of Portuguese and Dutch influence to the modern British period.

Associated geographically with India but politically separate, Ceylon from the currency angle has been torn by conflicting emotions. While at times the idea of an independent currency life may have presented some attraction, Ceylon's commercial relations with its giant neighbour on the one side, and with the United Kingdom, its principal customer on the other, combined with other factors to render such a course unsuitable. This result offers definite advantages in the case of a country with an undeveloped money market, since it is able to place on broader shoulders the burden and responsibility of currency management. But it is an essential condition of such a position that the monetary authority which bears that burden and responsibility should inspire confidence with

the general public. In this respect Ceylon has been favourably placed. The care of the rupee has always been one of the main preoccupations of the Government of India, while the growth and strength of the sterling area has afforded proof of the many advantages of maintaining the link with the London market.

In an unstable world currency, like other factors in human life, must have its vicissitudes. In his book Mr. Shenoy expounds the monetary history of the Island through the past centuries with lucidity and precision. He discusses in a practical manner possible lines of reform and development in the internal banking structure of Ceylon, examining in the course of his arguments the case for and against the creation of a Central Bank.

The book will appeal not only to those specially concerned with Eastern currencies, but also to the large circle interested in the general problems of money and credit.

CECIL KISCH.

PREFACE

IN comparison with the output of literature, especially in recent years, on the monetary history and problems of her big neighbour, the currency and banking systems of Ceylon have received little attention. Official publications on the subject are few and independent critical accounts are almost non-existent. The last report of a commission of enquiry on Ceylon currency is 38 years old and the only account of the Island's banking system is to be found in the report of the Banking Commission, 1934.

The difficulty attending a study of the subject is enhanced by the inadequacy of the primary material. Almost the only source from which the trend of currency policy and policy decisions can be ascertained is the monthly balance sheets of the Currency Commissioners, which are issued without comments of any sort. The Government does not publish any statistics relating to banking and, with the exception of the Bank of Ceylon which is a local institution, the balance sheets of the banks which have branches in the Island give no indication of their business in Ceylon.

I have endeavoured to supplement the available material by personal interviews and enquiries, and also by discussion with bankers, businessmen and officials of Government. The opportunity I have had of working for some time in the Department of Commerce and Industries, Government of Ceylon, has also afforded some help.

The book was nearing completion when the (Draft) Paper Currency Ordinance was published by the Government for general information and soon after the present war came upon us. The Ordinance is discussed in a separate chapter. After the Honourable the Financial Secretary

had moved the second reading of it on January 29, 1941, an amendment postponing its consideration for one year, on the ground that the present unsettled world affairs were unsuited for a permanent change in the currency law, was passed by a majority vote. The exchange control regulations and the related restrictions on imports, exports and the transfer of securities, which are among the chief changes introduced by the war, have been briefly examined in Appendix III. Appendix I gives a summary of the Island's currency statistics for the past forty years.

It is with some hesitation that I decided to retain the first thirty-six pages of the book (Chaps. I and II). They cover a field, which has been the special concern of the numismatist and the historian; but they embrace the origin or the period of early currency of some of the monetary denominations used either currently or in the recent past. The decision to include them in the book, however, has not in any way prejudiced the space or the attention devoted to contemporary developments.

I wish to express my gratitude to Dr. (Mrs.) Vera Anstey for finding the time, amidst great pressure of work, to read my MS., and for many helpful criticisms and suggestions. To Sir Cecil Kisch I am indebted not only for the Foreword but also for many valuable suggestions and criticisms, for which he was good enough to find time amidst the increasing pressure of work caused by the war.

My grateful thanks are due to Mr. W. D. MacBey, late Agent of the Imperial Bank of India, for reading portions of the MS. which deal with the Imperial Bank of India, and for much valuable discussion on the subject. Thanks are due also to Mr. C. E. Jones, Controller of Exchange, Imports and Exports, for reading Appendix III on Exchange Control, to Mr. J. G. Scroggie, Chairman of the Exchange Banks' Association, and Mr. K. A. Robertson, Manager of the Mercantile Bank of India, for reading the two

chapters on banking, and to Mr. W. B. Mackay, Manager of the Bank of Ceylon, for reading the chapter on the Bank of Ceylon. I am obliged to them for many useful comments.

I am also indebted to the Honourable Mr. H. J. Huxham, Financial Secretary, for clearing many points of doubt, and for allowing me access to the official records of the exchange rates. To Mr. J. C. W. Rock, late Director of Commerce and Industries, and to Mr. D. H. Balfour, the present Director, I am under obligation for the permission to make use of the unpublished official estimates of the Island's balance of payments. Mr K. Williams, Statistician to the Department, has also kindly assisted me in several ways. I am obliged to Dr. Colvin R. de Silva for allowing me the advantage of reading in MS. his doctoral dissertation. I wish also to express my gratitude to the librarians of the Colombo Museum, the Government Record Office, and the Ceylon University College for their courteous assistance. Thanks are due also to Messrs. L. W. A. Weerasekara, G. K. E. de Silva, and M. Mathiparanam for their assistance in checking up statistics in the tables and Appendix I.

It is also a pleasure to acknowledge the unfailing help I have received from my wife in collecting and tabulating statistics, in the preparation of the charts and the Index, in reading proofs, and in various other ways.

While I gratefully acknowledge all the assistance I have received from them, none of the persons mentioned above must be held responsible for any statement in the book.

COLOMBO
March 1941

B. R. S.

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CHAPTER I

THE EARLY PERIOD

I. *The Early Ceylon Currency*

CONCRETE information on which to base a consistent and connected narrative of the monetary system of the early times is not only sparse but also, generally, difficult of interpretation. Such information as I have been able to gather from numismatic and historical works I have pieced together in the following pages of this chapter. The result is none too satisfactory. Nevertheless it may be of some interest in view of the fact that some of the monetary denominations, especially the *pagoda* and the *fanam*, which were in common use until sometime after the beginning of the British rule, have their roots in this early period. The term *fanam* is used today to signify six cents.

Ceylon was subjected to the cultural and the economic influence of the mainland of India from very early times. *Kahapanas* or *puranas*,¹ the early coins of the Island, were of Indian origin. The date of their issue on the mainland is obscure. Sir Alexander Cunningham thought that the earliest specimens could be traced as far back as 1000 B.C.² Vincent Smith was inclined to assign them to 300 B.C. on the evidence then available. Recently Babu Durga Prasad has found reason for believing that the first estimate was, probably, not far wide of the mark. He would place the

¹ The *purana* has been identified with the ancient *dharana*, the silver *karshapana*, *kahapana* of the Sanskrit and Pali texts and classics, and with the *pana* of Kautilya. See Durga Prasad, 'Classification of Punch-marked coins of Ancient India', *J.R.A.S.* (Bengal) Vol. xxx, 1934, Num. Supp., p. 12.

² *Coins of Ancient India*, London, 1891, p. 43.

early issues about the eighth century B.C.¹ It is certain, however, that *puranas* were anterior to the time of Gautama Buddha and were well established in India in the fourth and third centuries B.C., when the Great Maurya Empire was supreme. They became the established currency of the whole of India, at some period, during the campaigns of Chandragupta the Great, and the settlement of the Empire under Asoka, his grandson. The *Arthashastra* mentions their having been minted (in addition to other coins) in Magadha, modern Bihar, in the time of Chandragupta.² It is not known how long after their issue in India *puranas* found their way into Ceylon. But it is conjectured that, they were in the Island in the second half of the third century B.C.³

Puranas were pieces of much alloyed thin silver⁴ (or more rarely copper) cut from a hammered sheet of metal and clipped to the proper weight. They were either rectangular or circular, the former shape being, probably, the more ancient.⁵ Their original standard of weight is supposed to have been the weight of a silver *dharana* (about 57.6 grains) or 32 *gunjas* or *ratis* (or *raktikas* weighing about 1.8 grains each) as laid in *Manu* and the older law books.⁶

Their obverse is covered with punch marks, which are often overlapping and were, clearly, impressed at different times. The marks on the reverse are fewer in number; in the great majority of cases there is only one: these are less distinct, and smaller in size. The symbols

¹ Op. cit., p. 6.

² H. W. Codrington, *Ceylon Coins and Currency*, Colombo, 1924, p. 17.

³ H. Parker, *Ancient Ceylon*, London, 1909, pp. 459-60.

⁴ Some chemically analysed specimens were found to contain 75% of silver, and about 25% of copper, with traces of iron and lead. Durga Prasad, op. cit., p. 12.

⁵ C. J. Brown, *The Coins of India*, Calcutta, 1922, p. 15.

⁶ Codrington, p. 1.

impressed are of wonderful variety, some 564 having been enumerated.¹

It is not clear who struck and issued the early coins. But it seems probable that, as in Lydia, this was done first by the goldsmiths or silversmiths, private merchants or guilds (*seni*), later submitted by them for the approval of the local king or governor, whose stamp was put on the reverse, and that subsequently the privilege of issue passed under royal control.² As to explaining the punch marks on the obverse there is no general agreement. Babu Durga Prasad has recently advanced the theory that they represent the 'test marks' of the *Rupadarshaka*, a currency officer of the king, who was entrusted with the responsibility of certifying the genuineness of coins.³ Others are of the view that they are the marks of the original issuing authority or represent endorsements by bankers and guilds through whose hands they passed.⁴

Puranas found in Ceylon, like those found in India, varied greatly in weight. The Ceylon specimens range between 28 and 39 grains.⁵ Original shortweight, varying degrees of wear and erosion, and probably also clipping are possible explanations. If the original weight of the coins was irregular and all of them had the same value as mediums of exchange, as may be inferred from references to money in contemporary Buddhist literature, *puranas* were only tokens, that is, they did not circulate in Ceylon at their intrinsic value. As imports were the only source of supply they may have had scarcity value.

¹ Durga Prasad, op. cit., p. 9.

² The practice of minting by merchants and others, with the approval of the king, obtained in India until comparatively recent times. The Dutch East India Company applied for, and was allowed, the privilege of working a mint at Negapatam by the Nayak of Tanjore. See Codrington, p. 82.

³ 'Observations on Punch-marked Coins', *J.R.A.S. (Bengal)*, Vol. III, 1937, No. 2.

⁴ Brown, pp. 15-16; Codrington, p. 16.

⁵ Parker, pp. 464-65.

Puranas formed the bulk of the coinage in Ceylon for many centuries. In northern India they did not remain current much after the beginning of the Christian era, while in the south they continued in use for a couple of centuries or so later. Since the currency of this Island was closely connected with that of south India, in all probability, the employment of *puranas* ceased in the south and in Ceylon about the same time.¹

They are a proof of the early trade of the country with India, of which there is ample evidence in the annals of both countries. Traders from Magadha are known to have made regular voyages to Burma and Ceylon across the Bay of Bengal.² But what the merchandise traded in was is largely based on conjecture. One of these conjectures is that the Magadhese traders brought with them cotton materials, beads and other ornaments, axes and arrow heads of steel, and cooking and other vessels of earthenware, copper, or brass. They took back with them Ceylon produce, which included ivory, wax, incense, and also pearls and gems for which Ceylon was famous.³

Trade between the two countries increased with the coming of Mahendra, the prince monk, about the middle of the third century B.C.⁴ This must have followed as a corollary to the growth of the Buddhist Church in the Island. It seems significant, therefore, that the earliest specimens of *puranas*, found in Ceylon, have been assigned to this period.

The use of money was first more common in the trading centres on the coast, where the merchants from Magadha called, and the seat of kings in the interior. It then spread elsewhere as internal trade developed. Imported

¹ Codrington, p. 16.

² Parker, p. 108.

³ Parker, p. 107; V. A. Smith, *Early History of India*, Oxford, 1924, p. 304.

⁴ Smith, p. 195.

money was supplemented, for small change, probably, by tamarind seed.¹ Ceylon documents are silent as to the existence of a cowry currency, which was in use in India.² The economy, however, was never wholly, nor even mainly, a money economy. As a rule, the villages were practically self-supporting, they continued to be so almost until modern times, and had little use for money. Exchange of the village produce as well as of such of the imported wares as reached the villages was done through barter.

From the close of the regime of the *puranas* down to the fourteenth century, the currency history of India permits of division into two parts, northern and southern. This was due to northern India, during the period, having been subjected to a series of foreign invasions and its currency having been continually modified by foreign influences whereas, with a few exceptions, the currency of the south was left untouched, to develop on purely Indian lines. The currency history of Ceylon was linked with the latter.

But there exist few sign posts to enable a satisfactory narrative of peninsular monetary history to be written. Although modern research has had much success in piecing together the skeleton of its political history, sufficient information on essentials, for our purposes, is lacking. Numismatists have not bestowed the same attention upon the currency of the south as they have done upon the more attractive currency of the north.

During the first two centuries of the Christian era, or probably longer, the currency of southern India consisted chiefly of imported Roman gold, and partly of *puranas* and spherules of plain gold, which last were the earliest specimens of purely southern money. With the cessation of *puranas* as money in the north, the source of their supply was cut off and consequently their proportion in the local

¹ Codrington, p. 16.

² Brown, p. 13; Smith, p. 314.

circulation diminished. Their place was taken by Roman gold coins, which circulated in southern India as freely as did the English sovereign on the continent of Europe before the Great War I, but in much larger numbers. These, along with the Roman bronze small change, partly imported and partly minted at Madura, were commonly used in the bazaars.¹

The Tamil states² were visited freely by ships from both East and West. Pepper, pearls, and beryles were precious commodities not procurable elsewhere and pepper in particular fetched an enormous price in the markets of Europe.³ While Europe was eager to buy these commodities, she could not find equally attractive merchandise which southern India could buy with as great eagerness. There was some demand for European wines, vases, and lamps,⁴ but payment for Indian exports had to be made mainly in gold for which the Indian appetite had always been strong. This largely sufficed to meet the demands of the domestic circulation and it was not necessary to do much minting locally.

The flow of Roman coins into southern India probably began with the opening of direct Rome-India trade relations, after the annexation of Egypt by Rome in the early half of the first century B.C. Early in the Christian era, Roman ships from the Egyptian province of the

¹ Smith, p. 462; 'Remarks on some lately discovered Roman coins', *J.R.A.S.* (Bengal), 1851, p. 372; R. Sewell, 'Roman coins found in India', *J.R.A.S.*, 1904.

² The Tamil country or Tamilakam, as it was known to the ancients, consisted of the larger part of the present-day Madras Presidency. It was the land of the Tamil race and speech, Malayalam, now the language of Malabar, not having been developed as a separate tongue until some centuries later. See Smith, pp. 456-57.

³ So highly was pepper priced in Europe that when Alaric the Goth levied his war indemnity from Rome early in the fifth century A.D., his terms included the delivery of 3000 lbs. of pepper. See Gibbon, ch. xxxi.

⁴ Smith, p. 462.

Empire began visiting the Malabar coast in large fleets.¹ They brought the *aurei* to Tamilakam just in time to take the place of the receding numbers of the *puranas*. The *aurei* comprised the main currency of the peninsula for a couple of centuries or more. Their decline in circulation synchronized with the decline of Rome and the rise of the Persians as a maritime people, who first rivalled and then eclipsed the trade of the Romo-Egyptian merchant fleets with India. From A.D. 364, the date of the final division of the Empire, a slight revival of trade set in but with the fall of Alexandria, in A.D. 638, all direct Roman trade with the East ceased and Roman gold could not have remained in circulation long thereafter.²

The currency history of Ceylon followed more or less the same lines. During the first two centuries of the Christian era the circulation consisted of *puranas* and Roman coins which latter, as in India, were got in exchange for pearls and gems. Hoards of gold and silver coins of the period between Augustus and Nero (who died in A.D. 68), many of which have been discovered in India, however, find no counterpart in Ceylon. It is possible, therefore, that the Roman traders arrived in the Island after they became familiar with the Indian coast. The decline of *puranas* in the circulation was coeval with the ascendancy of the *solidi* which remained the main currency of the Island for the first two centuries of the Christian era. It is not clear if they continued as such for a much longer period or whether some other currency replaced them. Sufficient evidence on the subject is not forthcoming. But there are references to Roman coins as late as the beginning of the sixth century A.D.³

The earliest among the extant specimens of locally minted

¹ V. A. Smith, *The Oxford History of India*, Oxford, 1923, p. 143.

² Sewell, op. cit.

³ Codrington, p. 34.

Ceylon coins, which were chiefly of copper, have been assigned to the first half of the second century B.C.¹ Most of them, however, belong to the Christian era and the last of the group were the 'Maneless Lion' type which were in use in the reign of Mahasen (A.D. 277-304).² Their mode of manufacture was crude. It is possible that, like the later Dutch issues, or the mediaeval English coinage,³ they were struck as so many to a unit weight of metal, the tola, and that, little attention was paid to the exact weight of individual coins. This seems to explain the extreme variations of their weight. They all, however, had the same face value⁴ and probably served as subsidiary money to the solidus.

Later, from about the last half of the fourth century A.D., their place was taken by Roman bronze coins or 'third brass', which were dumped into India and Ceylon by the western merchants. Large numbers of them have been discovered, at almost every petty port, with the noticeable exception of Trincomalee, which the Roman ships could not have frequented, as well as at various places in the interior.⁵ Their supply was cut short when direct trade with Rome came to an end, but they remained in circulation until the middle of the seventh century A.D. That they were in long use is seen from their much worn condition, the legends on the majority of them being quite illegible.

Mixed with the Roman coins have been occasionally found specimens of the *Andhra*, the *Parthian*, the *Indo-Parthian*, the *Kushan*, the *Gupta*, and the *Sassanian* coins.⁶ They reached the Island in the course of trade and were

¹ Codrington, pp. 16 and 26.

² Ibid., p. 25.

³ A. E. Feavearyear, *The Pound Sterling*, London, 1931, p. 4.

⁴ Codrington, p. 26.

⁵ The extant supplies of them do not seem to have been exhausted. A quantity of them, about 14 lbs. in weight, were brought to the Colombo Museum from Galangoda near Balapitiya on December 17, 1938.

⁶ Codrington, pp. 49-50.

valued for currency purposes in terms of the more familiar media of circulation.

The sixth and the seventh centuries are the 'dark ages' of Ceylon. Internal strife, which prevailed, has left few contemporary records of the period. Such meagre evidence as is available has led to the conjecture that payments in bullion, by weight, obtained as in contemporary south India,¹ where, *rane engili* or 'golden fingers' were the most common currency. Uncoined gold may have been current in the Island as dust, in small ingots, or as *rane engili*. The unit of weight used was the *Kalanda* (68-70 grains)² while in India it was the *kalanju* (45-54 grains)³. The practice may have originated with the cessation of the inflow of Roman coins. The disturbed political situation may have prevented a speedy revival of minting which by now had probably become a forgotten art, as Roman coinage had for long rendered unnecessary the maintenance of a minting establishment in the country. The earliest mention of coins by name occurs in the latter half of the seventh century. Probably they represent the first halting attempts at local coinage which subsequently developed into the so-called 'Lankeswera' coins⁴ or *kahavanuas* of gold. They may have been struck first as a deliberate revival of the *kahapana* of the Buddhist scriptures, supposed at the time to have been a gold coin. The weight of the coin, which had a fair admixture of alloy, was a *kalanda*,⁵ which was practically identical with the later Roman solidus. When the solidus became scarce a solidus-weight of bullion was, probably, accepted in its stead, which subsequently became the standard for the new coinage. Other gold coins of the period were *ada* (or half) *kahavanua* (about 34-35 grains), *pala* or *deka* (about 17-17.5 grains), *aka* (about 8.5-8.75 grains), and (?) *massa* (about 3.4-3.5 grains).⁶

¹ Codrington, p. 52.

⁴ Ibid., p. 54.

² Ibid.

⁵ Ibid., p. 73.

³ Ibid., p. 3.

⁶ Ibid., p. 53.

Rhys Davids assigned their issue to Parakrama Bahu I (1153-1186) who, it was argued, introduced into Ceylon the art of minting on his return from the Indian expedition in the twelfth year of his reign.¹ Mr. H. W. Codrington, however, has adduced valid reasons for thinking that they were issued, some about A.D. 900 and the rest during the tenth century.

The *kahavanua* could not have brought about a speedy return of the lost habit of accepting money by tale, in a country where habits die hard. Rather, as happened in modern China, where every new dollar meant to replace the ingots of 'sycee' silver was accepted by the community not by tale but by weight,² the new coins in Ceylon may have been subjected to like treatment. Not being pure gold they may not have received much popular favour and in all probability coin and bullion remained current together for a considerable time. In the kingdom of Kotte taxes due from goldsmiths, carpenters and blacksmiths were so paid as late as 1614.

The coinage up to the end of the tenth century was of alloyed gold, perhaps eked out with a few silver pieces. During the Tamil occupation of the capital (Polonnarua) and of the northern provinces of the Island (A.D. 1001-1073), when anarchy prevailed among the Sinhalese princes, it is not likely that any coins were struck by the latter. But when Vijaya Bahu I (A.D. 1055-1111) expelled the Tamils and reoccupied Polonnarua (1073), minting was begun once more. The coins issued, however, were much debased. They became worse in the twelfth and thirteenth centuries. At first they were of very poor gold, and then of silver washed with gold.³ Both were officially passed as gold,

¹ *On The Ancient Coins and Measures of Ceylon*, London, 1877, pp. 26-27.

² B. R. Shenoy, 'Chinese Monetary Reforms', *Journal of the Indian Institute of Bankers*, January 1937, p. 2.

³ Codrington, p. 73.

but could not have been accepted by the merchants and bankers for anything but their intrinsic value. Small change was of copper. Later, from the time of Parakrama Bahu I, the coinage of precious metals wholly ceased and there arose a new fraud of washing base metal with silver.¹ The state of Ceylon currency, during the period, is reminiscent of that of the decadent and bankrupt Roman Empire in the third century.

The debasement of the coinage was closely connected with the financial position of the exchequer. Civil war, which prevailed almost continuously until the strong hand of Parakrama Bahu I established internal peace, by the destruction it caused affected adversely revenue receipts, while repeated wars with the Tamil invaders drained the State resources. Though Parakrama Bahu I enjoyed the rare privilege of undisputed power, and the country had a long spell of peace, under his rule, the financial position did not improve. Probably it became worse. His daring expeditions of conquest into Kakadwipa and Ramanya, which meant the sending of a fleet of transports 1500 miles from home to the further side of the Bay of Bengal, and the incursions into southern India in aid of the Pandyan king and later against the Cholas, could not have been striking financial successes, although undoubtedly they threw additional lustre on the royal name and may have brought some booty and tribute. Vast sums were spent on religious and royal buildings and in making Palastipura, the seat of the king, 'one of the strongest and most beautiful cities in India'. The construction of inland lakes ten, twenty, even forty miles in circumference—one of them being the famous Sea of Parakrama—which were among the most remarkable engineering feats of the period and brought the king undying fame, involved enormous initial

¹ Codrington, p. 82.

outlay, though, after a period, they were productive of good results. These schemes so exhausted and impoverished the country financially that it was long before it began to recover from its effects.¹ Unable to balance the budget by taxation, the Sinhalese kings debased their coinage. Debasement increased with financial difficulties until at the time of Parakrama Bahu I the country had, perhaps, the worst coinage of the period.

In the middle of the fourteenth century, before the arrival of the Portuguese, the debased coinage of Ceylon was superseded by the *pagoda* and *fanam* currency which was supreme in south India about this period. Its circulation was continuous in the Island until the early part of the British rule. The earliest specimens of the coins in India have been attributed to the early Chalukyas (A.D. 550-753), from the appearance on them of the boar, the cognizance of this dynasty.² This coin-type was issued by several dynasties and clans, which, probably, explains the dissimilarity of their weights (50-60 grains). But their standard is supposed to have been one *kalanju*. Those issued by the Vijayanagar kings (1336-1565) are regarded as representative of the type. They were also coined in halves under various names, such as *pratapa* and *mada*. Subsidiary to the *pagoda* and its half was the gold *fanam*, which was one-tenth of a *pagoda* and weighed about 5-6 grains.³ Small change was of copper and was called *cashu* of which the English corruption is 'cash'.

The origin of the word *pagoda* is obscure. Its Indian name was *varaha* (Tamil, *varagan*). Mr. Codrington has advanced the plausible theory that, from the various issues of the half *pagoda* being known by the name of the king who struck them and the legends on them reading

¹ Rhys Davids, p. 23.

² Brown, p. 91.

³ The standard for the *fanam* is supposed to have been one *manjadi*. See Sir Walter Elliot, *Coins of Southern India*, London, 1886. p. 49.

'*Sri Pratapa Krishna Raya*', '*Sri Pratapachyutha Raya*' and the like, it usurped the name properly belonging to its half.¹ And to the Portuguese it was universally known as *pardao de ouro*, from which was derived *pagoda*. This name has superseded all other designations in English.

The *pagoda* being too large a value for the day-to-day transactions of the vast majority, the most common unit of circulation was the *fanam* and its subsidiary coins. The *fanam* is first mentioned in 1344 by Iban Batuta. In his day it weighed about 5.8 grains, but does not seem to have had a fine gold content of more than about 4.2 grains. Sometime between 1454 and 1505 there was struck the '*Sinhalese fanam*' of silver as a sub-unit of the gold *fanam* in imitation of the silver *fanam* of the mainland.²

The foregoing review indicates that, during the early times, the currency system of Ceylon largely conformed to that of southern India, except, probably, between the tenth and the fourteenth centuries, when, it seems probable, the Sinhalese kings issued a separate coinage. But if, during this period, bullion, in the form of *rane engili*, passed current in the Island, as seems likely, the closeness between the two systems was practically continuous.

II. *The Portuguese Period*

The currency history of the Island under the Portuguese is not less obscure than the early period. The headquarters of the Portuguese possessions in the East was Goa. The chief mint of the Empire was in Goa and the minting of coins in other possessions was discouraged. The Portuguese currency policy, as a result, was greatly influenced by the currency needs of Goa. The requirements of other possessions did not play more than a secondary part. If we are to see the currency history of Ceylon, during the period, in its proper perspective, it

¹ Codrington, p. 91.

² Elliot, pp. 146-48; Codrington, p. 81.

is necessary, therefore, to have an idea of the Indo-Portuguese currency developments.

When Vasco da Gama arrived on the Malabar coast in May 1498 the principal coin in circulation in southern India was the *fanao* or *fanam* of more or less base gold. Throughout the Vijayanagar Empire, which covered practically the whole of the southern part of the peninsula, the standard coin was the gold *pagoda* and its half the *pratapa*. Writing about 1516, Barbosa states that 'it is coined in certain cities of this kingdom of Narasinga, and throughout all India they use this money, which passes in all those kingdoms; its gold is a little inferior'.¹

Soon after the conquest of Goa, in 1510, from the Muslims, to whom, in the meanwhile, it had passed from Vijayanagar, D'Albuquerque struck *cruzados* in gold, *esperas* in silver, and *leaes* (singular, *leal*) in copper as the equivalents, respectively, of the locally current *pagodas*, *barganins* and *bazarucos*. Although the issue was said to have been made at the entreaties of the inhabitants, it does not seem to have received much popular support. The new gold and silver coins could not rival the popularity of the local money and did not last beyond 1519. Only the *leal* continued to be struck by the viceroys and remained in circulation; it was rated in varying terms of the *reis*, from time to time. Thereafter, the currency in the higher metals consisted largely of *pardaos d'ouro* or *pagodas*, *xerafims* of gold, and silver *larins* (originally made in Lari on the Persian Gulf but later, owing to its popularity, extensively imitated)² or *tangas de prata* (also called *hook-money* or *kokku kasi*) in addition to the gold coins of Portugal and Venice. Of the gold coins, *pagodas* were more numerous than the rest. The Hormuz *xerafim* and the *larin* were the common trade coins of the west

¹ Quoted by Codrington, p. 99.

² Rhys Davids, p. 34.

coast and of the Arabian Sea. Thus the currency system introduced by D'Albuquerque was soon superseded by one of mixed denominations of *pagodas*, tangas and leaes.

The monetary system of Portugal, during the period, consisted of the *crusado* of gold (weighing 54.75 grains) which was the equivalent of the ducat, its multiple the Portuguese (weighing 547.585 grains), valued at ten *cruzados*, and small change of copper called *real* (plural, *reaes*, *reis*). A few of these gold coins found their way into the circulation of Goa but not the *real*, which, however, was adopted as a monetary unit of account, as in all Portuguese possessions in the East. Local money was valued in terms of *reis* for uniformity of reckoning and in a unit familiar to the rulers.

The Portuguese first arrived in Ceylon in 1505, eight years after Vasco da Gama had rounded the Cape of Good Hope. The visit was followed thirteen years later by the construction of a fort in Kolontota, the Colombo of today. But it was not until 1597 that the king of Portugal and Spain was proclaimed sovereign of Ceylon.

When the Portuguese arrived in the Island its currency system was the same as on the mainland and comprised gold *pagodas*, gold *fanams*¹ and the locally minted silver *fanams* (the Sinhalese *fanams*). In addition, there were also in circulation *larins*, which are constantly mentioned throughout the Portuguese period. A principal coin of the Arabian Sea, in all probability, it was introduced by the Muslim merchants before the coming of the Portuguese, although the first record of its use occurs under the year 1517.²

¹ *Pagodas* being too large value for the everyday transactions of the majority, as noted above, *fanams* were the more common units in circulation. The wages of a mercenary soldier in 1539 are stated to have been 4 *pagodas* a month. See P. E. Pieris and M. A. H. Fitzler, *Ceylon and Portugal*, Leipzig, 1927, p. 40.

² Codrington, p. 95.

For the first thirty years of the Portuguese occupation, the more common media of circulation remained the gold *fanam*, the silver *fanam* and the *larin*, while the larger money units comprised besides the gold *pagoda*, which was more numerous than the rest, a large variety of money units, as in most small trading nations of the world during the period. Among the latter could be counted a few Portuguese gold pieces minted in Portugal, the Venetian sequin, and the Hormuz xerafim. An idea of the components of the circulation of this period may be had from the 'Inventario do Thesouro do Rei de Ceylao', which, in describing the treasure captured in 1551, mentions the following collections of coins¹:—

King's treasure at Kotte:—

5444 new xerafims of Hormuz..	each of 300 reis.
6005 cruzados and Venetians.....	„ 7 tangas.
556 Portugueses d'ouro.....	„ 15 pardaos
122,330 new <i>fanams</i>	at 30 the xerafim.
120 tangas de prata (larins).....	at 5 the pardao d'ouro.
5 pardaos d'ouro.....	of 6 tangas.

Temple treasure at Sitawaka:—

142 new xerafims of Hormuz.
2 Portugueses d'ouro.
2 madrafaxoes ² of 21 tangas each.
10½ pardaos d'ouro.
1 dobroao d'ouro.
8 pardaos 2 tangas in larins (i.e. 42 larins).
9½ ounces of fanoes chocroes. ³

This includes nearly all the kinds of money that were current in Goa, with the addition of the *fanam*, which has

¹ Quoted by Codrington, p. 96.

² The Madrafaxao was the Mudhaffar Shahi gold piece of Gujarat weighing 169 grains. Codrington, p. 93.

³ Chocroes were *chakrams* or *chakra-panams*. Ibid., p. 95.

not been mentioned in the case of Goa. The meagre numbers of the *pagodas* and *larins* do not do justice to their actual proportion in the total circulation. An explanation that has been suggested is that *larins* and *pagodas*, being the more common media of circulation, were first drawn upon to pay the troops etc., in the campaign against Mayadunna, king of Sitawaka, while the other coins remained in the treasury. There is ample evidence of the extensive circulation of *pagodas*. In 1550, Mayadunna, we are told, had paid a war indemnity of 100,000 *pagodas*, and, about 1555-56, the Sinhalese are said to have hired Portuguese soldiers at the rate of 15 *pardaos d'ouro* per man.¹ Later in the century, about 1596, the Portuguese are reported to have captured seven elephants loaded with treasure, five of which carried *larins*, a fact which vouches for the currency of this coin as well.

The Portuguese, however, failed to improve the currency system of the Island. They do not seem to have made any serious attempt to substitute the local circulation by a money system of their own. Probably, the meagre success which attended their efforts in Goa, in the direction, deterred them. The issues from the Goa mint² were progressively debased notwithstanding the efforts, which were made from time to time, to prevent it, and could not have remedied the disorganized state of the monetary circulation. The gold S. Thome (52.8 grains), which was struck in 1548-49 to pass as the equivalent of the *pagoda*, was followed in 1550 by the silver S. Thome (408.6 grains). The latter was debased in 1554. In 1579 there was struck

¹ Codrington, p. 95.

² No coins were struck either in or expressly for Ceylon before the proclamation of Philip II as sovereign of Ceylon (1597), and it is doubtful whether this was done in any appreciable amounts thereafter. The only Captains-General of the Island who are known to have issued money were D. J. de Azevedo (1594-1612) and D. C. de Sa (1619-1622 and 1623-1630).

the silver xerafim (340.4 grains) to take the place of the Hormuz xerafim, which too, like the silver S. Thome, suffered progressive debasement. The silver S. Thome, the coinage of which was stopped in 1556, reappeared in 1595, as by now there was felt a scarcity of money of higher denominations, which had been driven out by the debased silver coins.

After the fall of the Vijayanagar Empire, the *pagoda*, which had been hitherto free from debasement, varied in weight and lost in fineness, as it was now issued by the late feudatories of the Empire. Debasement of the coin became worse in 1631. Meanwhile there flowed into the Island American silver in the form of patacas or Spanish pieces-of-eight. Payments in terms of them have been recorded in Jaffna about 1560 and many stores of the coins were found in 1584 at the sack of Sitawaka. By 1640, as in a great many other countries, it had become a chief medium of circulation in the Island.

The multiplicity of coin-types, which remained in circulation simultaneously, practically throughout the Portuguese period, was the source of a great deal of confusion. Being products of several mints, which followed as many mint regulations, the coins were of different standards of weight and fineness, both of which, moreover, were subjected to frequent alterations, nearly always downwards.¹ Several coins of varying weight and fineness, and sometimes of different metals, answered, at one and the same time, the same description of *pagodas*, patacoes, xerafims, sequins, larins, tangas, S. Thomes, or *fanams*.

The Portuguese sought an escape from this confusion by adopting the real, in which they kept their accounts, as

¹ The frequent changes in the weight of coins are illustrated by the history of the tanga. It weighed 68.4 grains in 1569, fell to about 56.59 grains in 1594, 50.5 grains in 1614, 44.1 grains in 1630, 33.8 grains in 1642, and 32.4 grains in 1650. See Codrington, p. 101.

the common unit of valuation for all coins, and by creating moneys of account with fixed values in reis. Thus there arose two distinct modes of monetary reckoning, one in terms of the money of account or the standard of value, and the other in the terms of the actual coin, which served as the medium of exchange, both bearing the same denomination. The value in reis of the former remained stationary while that of the latter fluctuated. Sometimes this led to the curious position of an imaginary money of account without a coin to represent it. It resulted through the lapse from circulation of the latter and the persistence, through habit, of the former.

Thus there were *pardaos de tangas* or *pagodas* of account valued at 300 reis each, as distinguished from the *pardao d'ouro*, which name stood for the gold coin. The latter, at first rated at 360 reis, was allowed later to find its own level. Similarly there was a *xerafim* of account of 300 reis and *xerafim* the coin from Hormuz, reckoned as equal to the gold *pagoda*. Likewise, during the first half of the sixteenth century, when silver was in great demand in the Far East, there was created a *tanga* of account of 60 reis, following the rise in the valuation of the *larin* or *tanga de prata* from 60 reis to 72 reis.

The table of valuations which remained in force from about 1614, of the money of account of the more common denominations, in Ceylon reis, was as follows¹:—

<i>Fanam</i> of silver (<i>fanao de prata</i>)	
	= 6 bazarucos
	= 5 reis
<i>Tanga</i>	= 60 reis
<i>Larin</i>	= 100 reis
<i>Xerafim</i>	= 300 reis
<i>Patacao</i>	= 400 reis

¹ Codrington, p. 98.

The Ceylon reis differed from the reis of Goa : five of the former were considered equal to 4.5 of the latter. The market value of the coins varied appreciably from the value assigned to the corresponding units of account given in the table. In the middle of the seventeenth century, for instance, the larin was worth 120 Goa reis and the xerafim 360 Goa reis¹ while, in the table, they are worth 100 Ceylon reis and 300 Ceylon reis respectively.

¹ Codrington, p. 98.

CHAPTER II

THE DUTCH PERIOD

I. *The Early Measures of the Dutch*

THE 'Cinnamon Island' had attracted the attention of the Dutch, who were the first to contest the claim of Portugal to the monopoly of oriental commerce, from the early days of their enterprise in the East. But the preoccupation of the United Dutch East India Company in the Malay Archipelago and the misfortune which befell the expedition of 1603 delayed execution of their plans. In 1638, however, when their position in the Archipelago had become sufficiently strong, they attacked and captured Batticaloa. Trincomalee was taken in the following year, Galle in 1640, Negombo, after an initial reverse, in 1644, Colombo in 1656, and Mannar and Jaffnapatnam, the last two Portuguese fortresses, in 1658.

From the very start the question of the currency had engaged the attention of the Dutch. Clause 14 of the treaty, concluded in 1638, by Adam Westerwold, the Dutch Commander, with Raja Sinha, the king of Kandy, provided that 'no one . . . except when appointed thereto by the King and by the Dutch shall have power to coin, make, or circulate money, much less to make base coin'.¹ Relations between the two parties, however, soon became strained and no joint action, as contemplated in the treaty, was taken. In 1640, when William J. Coster, the first Dutch Governor, called the attention of the king to 'an irregular currency . . . (which had) . . . crept in by the usurpation of the Portuguese, injurious to commerce', he

¹ R. G. Anthoninz, *The Dutch Records*, Colombo, 1907, p. 130.

met only with vague promises¹ and the matter was not pursued further.

During the early years of the Dutch occupation of Galle the currency consisted of the Spanish pieces-of-eight, cruzados, S. Thomes, tangas and other silver coins of the Portuguese, gold and silver *fanams*, and *larins*. To this collection the Dutch added their own money,² but as in Batavia, the headquarters of the Dutch possessions in the East, chiefly 'payments', i.e. silver coins called *schellings*, *dubbeltjes* (double *stuivers*) and *stuivers*, most of which were badly worn or clipped. For a community of small incomes, however, Dutch money, even the *stuiver*, represented large value. In 1644, therefore, the Batavian Government issued half, and quarter, *stuivers* of copper, weighing 118.6 grains and 59.3 grains respectively, for use in the settlements of the Company. The copper *stuiver* and half *stuiver*, of which the latter became known in Ceylon as 'tammekasje', comprised the chief media of circulation for the bazaar transactions throughout the Dutch occupation of the Island and for part of the British rule.

While yet the Portuguese had not been driven out of the Island altogether, much attention was not paid to the question of currency reform. Attempts in the direction were bound to be fruitless, as during the period of political uncertainty, falsification of coinage increased and the Portuguese dumped into the country debased coins. But soon after the conquest of the peninsula, steps were taken to

¹ 'Extracts from the *Dag-Register* of Batavia', *Ceylon Literary Register*, Vol. II, 1887-88, p. 336.

² The currency of the Netherlands, at the time, was the multifarious coinage of the Dutch provinces and cities, and the great variety of coins brought in from all parts of the commercial world in payment of goods and the services of Dutch shipping. The standard coin in use was the Netherlands rix-dollar, but a great part of the current specie, not excluding the rix-dollar, was below the legal weight, either from wear, clipping, or irregularity in coinage.

have all the foreign coins in circulation stamped with the Company's monogram. In June 1661, the Master Attendant of the Shipping was instructed to see that no Portuguese coins were accepted without being stamped with the Company's mark and that 'none but good coin must be circulated in the Island according to the orders of our authorities'.¹ Chiefly as a result of this restriction, Portuguese coins soon ceased to form part of the circulation. Wouter Schouten, writing about 1661-62, makes no mention of them. According to him the principal coins in circulation in Malabar, Coromandel and Ceylon, were the silver *larins* worth 10 *stuivers*, silver and gold *fanams*, as well as 'pagodas or Moorish Ducats'.²

II. *Dutch Currency Policy*

One of the great problems of the Dutch, as of other European Companies, (even as that of the early Roman traders), was that the eastern markets could not absorb any considerable amount of European articles.³ And they were not slow to discover that they could not export an unlimited supply of money, from their own country, in payment of pepper, spices, cottons and gems, which were in great demand in Europe. Finance by borrowing was out of the question as money could not be had in India except at uneconomic rates of interest. The Dutch sought an escape from this position by entering into the trade between India and the Far East, which was, hitherto, controlled largely by the Arab, and the Indian, middlemen. In order to facilitate this trade they established factories on the Coromandel Coast and elsewhere on the mainland

¹ *Instructions from the Governor-General-in-Council of India to the Governor of Ceylon, 1656-65*, Trans., Colombo, 1908, p. 66.

² Codrington, p. 110.

³ W. H. Moreland, *From Akbar to Aurangzeb*, London, 1923, p. 58 et seq.

of India. They exported spices, pepper, and sandal-wood, from the Malay Archipelago to the Coromandel Coast, and brought in return, textiles from the Coast and Gujarat.¹ They had the practical monopoly of trade with China and Japan. From the resulting profits, which were enormous,² they exported to Europe the much-prized products of the East, importing specie only when it was convenient or absolutely necessary.

The same guiding principle governed the policy of the Dutch in Ceylon in relation to currency, trade and finance. It was dictated by the demands of the Company's trade in south India. The interests of the Island were made subservient to the necessity of financing the purchases of cloth from Coromandel and Madura, and pepper from Malabar, destined for Batavia and the Netherlands, as well as exports to the Fatherland of cinnamon; pearls and chanks³ from Ceylon. All the factories in the Indian peninsula, until 1680, and Tuticorin and Kilcare, throughout the Dutch rule, were administered by Ceylon. They had to be supplied with currency acceptable to the traders from whom the factories bought the merchandise for export and who, not being subjects of the Company, would not accept its tokens. This was done out of the surplus exports of the Island.

As part of this policy, the Dutch encouraged trade with

¹ *The Cambridge History of India*, Vol. V, p. 36.

² The Dutch always aimed at monopoly rights in trade, which they established by treaty, force of arms, or proclamation and never failed to make full use of them. Referring to the monopoly in the cotton goods trade van Imhoff wrote to his successor, W. M. Bruynink, in 1740: 'A profit of 92 per cent has been made in this branch of industry, notwithstanding the ignorance, carelessness, and covetousness, of the officers employed at Madura, and in spite of the fact that the coins there are accepted at a much higher value than they are really worth, and of the purchase value having been raised in order to save the industry from the decline to which it was apparently tending.' *Memoir*, Trans., Colombo, 1911, p. 33.

³ *Turbinella pyrum*; Hindi, *Shankh*.

such countries as bought more from the Island than sold to it. The trade, which the Island and the Malabar Coast, carried on with Persia in pepper, cinnamon, cardamoms, etc. was thus regarded most important. It brought the Company enormous profits and supplied the Island with one of its chief money media, the larin. Other important trade links were with Coromandel and Bengal. Bengal took from Ceylon elephants, chanks and cinnamon, and pepper from Malabar. It supplied in exchange, cloth and rice. The Coromandel took from the Island arecanuts, elephants, pearls and cinnamon in return for cloth, agricultural implements, plough-cattle, cows and other live-stock. Some trade was also done with Surat and Canara. The trade balance with all these centres was usually in favour of Ceylon and was settled in cash, which, however, could reach the Island only when not diverted to the Indian factories.

In order to be able to keep at the disposal of the factories on the mainland, as large a portion of the sale proceeds of the Island's exports as possible, the Dutch pursued early the policy of developing its agriculture and industry with a view to self-sufficiency in rice and, as far as possible, cloth.¹ Workers were brought from Tanjore to cultivate rice fields, and weavers from Coromandel. The latter were settled mostly in Jaffna, where cultivation of cotton was encouraged. Steps were also taken to encourage barter of arecanut and other local produce for cloth and rice to prevent payment for them in specie.² These attempts were attended with considerable success.

¹ ' . . . Our most important object as regards the whole Island' wrote R. van Goens, Sinr., in 1663 in his *Memoir*, '(is) that we should use every endeavour in order to keep our money within the country and to increase its products, so that we need not be dependent on outside sources, to which end the means are not lacking if only they are assiduously pursued.' *Selections from the Dutch Records* No. 3, Trans., Colombo, 1932, p. 17.

² Ibid.

By 1663 Jaffna was producing its own requirements in rice,¹ and in a couple of years more, Galle and Matara.² About 1668, further to stimulate the production of rice, the Company undertook to purchase paddy from 'all farms in the districts of Colombo and Galle' at a guaranteed price of from 14 to 15 stuivers per *parra*.³ Mainly as a result of this policy, the Island produced in 1679 sufficient paddy not only to meet its own wants but also to leave a surplus which was disposed of in Madura and Negapatam. The Dutch also explored the possibilities of raising additional export crops in the Island. For example they paid attention to the planting of coffee in 1720 and pepper in 1753.

When the surplus exports fell short of the financial requirements of the factories on the mainland, so far from any fresh coins or metal being allowed to flow into the country, the Company withdrew genuine coins from circulation for export to India, either by replacing them with tokens or even by currency starvation. Such a situation arose in the 'seventies, when the initial drive for better and more agriculture slackened, the third Anglo-Dutch War (1672-74) having absorbed the attention of the authorities. The Dissavas, whose special responsibility was the betterment of agriculture, caused it to suffer through 'laziness, careless supervision, and remissness'.⁴ Labour had to be diverted from villages to the fortresses and to Colombo, in order to strengthen as well as to man the fortifications.

¹ *Selections from the Dutch Records*, op. cit., p. 15.

² *Ibid.*, p. 28.

³ The guaranteed price was lowered to 10 stuivers in 1679, when the Island produced sufficient to meet its own wants and leave a surplus. The market price then was 1½ stuivers per *parra*. See *Memoir of R. van Goens, Junr.*, Trans., Colombo, 1910, pp. 5 and 13.

⁴ *Selections from the Dutch Records*, op. cit., p. 28.

Raja Sinha's 'brigands' also gave some trouble. Consequently rice had to be imported in large quantities during the three years preceding 1675. Transport by sea being unsafe, merchants from Bengal and Coromandel, who visited Galle and Jaffna annually to purchase elephants, stayed away while hostilities continued. The Company's trade generally suffered, as trade routes were the scenes of war.

Simultaneously, expenditure mounted up. The war cost the Ceylon Government '22 tons of gold' or 2,200,000 guilders, in erecting or strengthening fortifications, in satisfying the mutinous soldiers and sailors, and in the purchase of provisions.¹ The whole of it had to be borne by the Island and its dependencies on the mainland. The measures taken after the conclusion of peace to increase revenue and to retrench expenditure, no doubt, produced surplus budgets. But the excess of revenue over expenditure was not sufficient to wipe off the war-time deficits and at the same time provide funds for financing the Indian trade. Renewed instructions were, therefore, received from the Fatherland to stop, altogether, imports of specie into Ceylon. The Government of Ceylon was directed to see that 'all rupees coming from Soeratta (Surat)' in payment of the Island's exports were sent to 'Bengal as soon as possible'; similarly, the 'ducats brought from Mocha, . . . must be sent to . . . Coromandel by the first opportunity'.²

III. *Debasement of Coinage and Currency Scarcity*

This policy greatly affected the local monetary circulation. Not only was hardly any specie added to it, but it was drained of gold and silver coins, chiefly by the

¹ *Memoir* of R. van Goens, Sinr., pp. 30 and 50.

² *Memoir* of R. van Goens, Junr., p. 11.

Government, which sent all it could collect to the continent and partly by smugglers as, '25, 30 or more per cent profit could be made on rupees, abacys, and *pagodas*' exported to Coromandel, Madura, or Negapatam, owing to the great scarcity of money in those parts.¹ The requirements of the domestic circulation were met by the issue of copper cassens, chiefly the product of the mint at Pullicat and partly of a local mint established in 1675, the first Dutch mint in Ceylon. By 1679, 'coin of other metal (was) hardly in use'. But even copper could not be spared in sufficient quantities for minting and the cassens rose in value to 'nearly twice as high as the value of the copper they contained'.²

The scarcity of money of the higher denominations, which the export of specie had given rise to, led to counterfeiting on an extensive scale, specially of silver 'abbasis. Measures to have the good coins stamped with the Company's mark were of little avail as the mark itself was forged. In 1691 there were discovered diverse false 'abbasis of lead, copper and pewter. Their circulation was banned in February 1702. A similar fate befell the Negapatam *fanams*. In 1693 it was found that half of them in circulation were spurious. Expert money changers were, therefore, brought from Negapatam to sort the good *fanams* from the bad ones and, after the lapse of three days' notice, which was given, all bad *fanams* were treated as bullion.

Prolonged war had also led to counterfeiting on the Coromandel. 'The golden pagoda is a coin,' wrote Hendrick Zwaardecroon, in March 1697, 'which was never or seldom known to be forged, at least so long as the King of Golconda or the King of the Carnatic was sovereign in Coromandel.

¹ *Memoir of R. van Goens, Junr.*, p. 11.

² *Ibid.*, p. 9.

But the present war, which has raged for the last ten years in that country, seems to have taken away, to some extent, the fear of the evil and the disgrace which follows it, and to have given opportunity to some to employ cunning in the pursuit of gain', and 'pagodas have been made which, although not forged, are yet inferior in quality'.¹ These *pagodas* were being imported into Ceylon, mainly Jaffna, and passed off for good ones. Tax collectors found it profitable to exchange silver and copper, which they received, for *pagodas* and pay the latter into the treasury. They thus acted as instruments for the working of Gresham's Law precisely in the same way as the officers of Charles I, collecting ship-money, had helped in the working of the law, in England, at an earlier date.² The notification of November 18, 1695, which had forbidden the circulation of inferior *pagodas*, apparently, had no effect.

These measures failed to solve the currency difficulties. The heavier coins had left for the mainland, the 'abbasis and mahmudis had been demonetized, *fanams* had been called in, and there remained only copper coin, much-worn silver and, chiefly in Jaffna, the inferior *pagodas*, the currency of which had been forbidden. The milder policy pursued by the administration from the Governorship of de Heere (1697-1702) had affected the revenues. Generous concessions and tax remissions had been made, and the interests of the Company had generally suffered through laxity on the part of the officials, who paid more attention to their own private gain.³ There followed a succession of deficit budgets which, retrenchment in expenditure, would not remedy. Consequently, the ability of the Government to finance the trade in Madura, where great scarcity of *fanams* prevailed, was impaired. Owing to the disorder

¹ *Memoir of Hendrick Zwaardecroon*, Trans., Colombo, 1911, p. 63.

² Feavearyear, p. 84.

³ *Memoir of Baron van Imhoff*, p. 5.

in the surrounding territory, the *fanam* mint at Trichinopoly had been closed in November 1705, and nearly all the small money had gone out of the country. Funds had, therefore, to be got from the Fatherland and in 1703, 12,173 European ducats were received, mainly for the Madura trade, and, in 1704, 148,846½ rix-dollars worth of 'payments', which included 12,875 rix-dollars in single stuivers,¹ for the local circulation.

The imported coins, however, instead of improving the situation, made it worse. The ducats, which purported to be of full weight, were in fact not so, and nearly the whole consignment of 'payments' was badly worn and unfit to serve as currency. Apparently, the Company had collected the worst among the coins current at home and had shipped them to the East. The state of the circulation as a consequence, became perfectly scandalous. According to the Batavian Plakkaat (Proclamation) of 1707, published in Ceylon on October 15, the stuivers 'were worn with circulation and had become somewhat red or had a crack or hole' and the Surat rupees had various 'marks or dots on the edge or on the face or . . . a crack or hole'. The rupees were current for 4 instead of 5 schellings, the schellings for 4 instead of 6 stuivers, and the double stuivers for one stuiver. The Plakkaat roundly rebuked the 'many lovers of filthy lucre', who insisted upon putting on these coins their proper value, and decreed that, all Surat rupees, if not clipped, should be current for 5 schellings or 30 'heavy' stuivers, and that schellings and dubbeltjes 'so long as the impression on one of both sides can be distinguished', however defective they might otherwise be, should pass for 6 and 2 stuivers respectively.²

The new policy introduced by Hendrick Becker (1706-1716) did not improve the currency position, though Becker

¹ Codrington, p. 115.

² Ibid.

had succeeded in removing what was, probably, a chief cause of currency deterioration by restoring the long-lost budget equilibrium. He put down corruption with a strong hand and prevented the leakage of Governmental profits and revenues into private hands or into those of corrupt officials. Expenditure was drastically cut down and the budgets showed revenue surpluses.¹ The urgency for subventions from home having, thus, been removed, the Government was no longer faced with the necessity of having to put into circulation worthless coinage, in which the subventions were almost invariably received.

But, as revenue surpluses had to be placed at the disposal of the Madura trade, the currency situation could not show any positive improvement. The problem of the shortage of silver and copper, which had only been obscured by the deteriorated coinage brought from the Fatherland, but had never been adequately solved, reappeared. It remained a chief feature of the currency position for a considerable time. The new coinage which the Company minted at home in 1727 for circulation in its eastern possessions, failed to provide any relief. The duits of copper, which were the 'first issue, were introduced in Ceylon by Plakkaat of August 8, 1731. They were followed by single stuivers and ducatoons, rated at 79 stuivers, in 1729. Clipping continued as usual and the old story was repeated over again. Good coins were driven out of circulation by the clipped ones. This provoked the issue of proclamations penalising clipping. As usual the proclamations went unheeded and the export of (relatively) good money gave rise to shortage of cash. The next step was to raise the valuation of the good coins, in an effort to keep them in circulation, but without avail.

The success which attended the efforts of Imhoff in

¹ *Memoir of H. Becker, Trans., Colombo, 1914, pp. 41 and 46.*

extricating the finances of the Government from the mismanagement into which they had relapsed after Becker had left the Island, proved of little value. With the accession to the throne of Kandy by a prince of Madura, the new Court became aggressively hostile. This meant loss of profits on cinnamon, for the production of which the Company depended on the king's territory, as well as inroads into the Company's trade of the extended illicit traffic, which the king carried on with the opposite coast, in cinnamon, arecanuts, pepper and coconuts. The accumulated surplus, as a result, disappeared and budget difficulties raised their head once again.

Duits were now almost the only (relatively) good money and for want of sufficient supplies of them the daily trade was much paralysed. Trade in arecanuts was at a standstill as the Kandians would not accept 'payments'. The issue in May 1747 of 'boezeroeken' out of an alloy of half lead and half tin could provide little relief, as the Kandians would have nothing to do with them and the Company's subjects would accept them only under compulsion.

While Ceylon was thus abandoned to greater and greater monetary stringency, funds rightfully belonging to the country were diverted to the purchase of calicoes for export to the Fatherland or Batavia, and the internal circulation was being drained of such available coins as were acceptable to the merchants at Madura. The *Memoirs* of successive Governors give us an idea of the limits of inconvenience to which the Government was prepared to submit itself to, as well as to impose upon the people, in order to subserve this requirement. 'Nevertheless all this did not prevent us,' wrote J. G. Loten, in February 1757, 'from placing at their disposal a sum of 150,510 *pagodas* with a view to removing as far as it lay in our power all the difficulties raised by them to carrying on the trade, and if they notified the least shortage to us we should have

supplied them with still more; and with the same object in view we also sent them a good quantity of Japanese copper in bars, powdered sugar, and every thing that we could possibly imagine could be disposed of there'.¹

The hardships, which the Island had to suffer, as a consequence of this policy, were reinforced by the small-pox epidemic of 1754-55, which depopulated the countryside in the maritime districts. Before an effort at recovery from its effects could be made, the country was swept by a great cyclone in May 1755, which devastated the pepper plantations in the Galle and Colombo districts and uprooted coconut trees. The poverty of the people, already great, became still more acute.

IV. *The Arrival of Milled Coinage and the 'New Ratings'*

All the while the clipping menace continued. Escape from it was not possible without the coming of milled coinage, which alone, as in other countries, could successfully circumvent the evil. This arrived in Ceylon in January 1763 in the form of milled ducatoons, struck in the Netherlands since 1753. They were declared legal tender in Ceylon for 80 stuivers and the new schellings and dubbeltjes at $7\frac{1}{2}$ and $2\frac{1}{2}$ stuivers respectively. In 1768 the policy of drift, which had, hitherto, mainly prevailed was finally put an end to, by introducing into the Island the 'new ratings' for the circulation.

This is a landmark in the currency history of Ceylon under the Dutch. All gold and silver coins were to be valued at their intrinsic worth with the new milled ducatoon of 66 Holland stuivers (or 80 'Indian' stuivers) as the basis of reckoning for silver coins and the Netherlands ducat of 105 Holland stuivers for gold coins. The bewildering confusion between 'light' stuivers, 'heavy' stuivers, and

¹ *Memoir*, Trans., Colombo, 1935, p. 33.

the Holland stuivers was thus at last done away with. Hitherto, the ducatoon, which had been accepted, in practice, as the standard coin, had necessarily to be given progressively higher ratings in terms of 'payments', as the latter deteriorated through clipping. But the coin had remained in Holland throughout at 63 stuivers. This had gradually led to a differentiation being made between the stuiver current in the Indies and that in the Netherlands, the former being called the 'Indian' stuiver. It was described as 'heavy' or 'light' according as it was clipped or unclipped. This latter distinction gradually lost significance as the 'heavy' coins became scarce, and the clipped and worn ones passed for 'heavy' money. Thus the Spanish dollar which was valued at 60 'light' stuivers in 1658, appears again in 1748 in the Batavian Plakkaat Boek rated at 60 'heavy' stuivers, the latter term having taken the place of the former. The 'new ratings' of 1768 accepted the 'Indian' stuiver, as the standard stuiver for the Island. The valuation of the legal tender currencies, under the 'new ratings', which theoretically remained in force until the close of the Dutch rule in the Island, was as follows:—

Milled ducatoon	...	= 66	Holland stuivers	= 80	Indian stuivers
Old ducatoon	...	= 63	" "	= 78	" "
New Negapatam and					
Tuticorin Pagodas	...	= 83	" "	= 100	$\frac{20}{33}$ "
Surat rupee	...	= 24	" "	= 30	" "

The fixed ratio between copper and silver, as enforced by the 'new ratings', depended upon the provision for the conversion of copper into ducatoons, on demand, at the rate of 80 stuivers to one silver ducatoon. The 'Treasury at Colombo received and exchanged them at that rate'.¹ While this was the chief factor, the sale of bills on Amsterdam at officially fixed rates may have helped to keep

¹ A. Bertolacci, *A view of the Agricultural, Commercial and Financial Interests of Ceylon*, London, 1817, p. 78.

up the artificial value of copper. On account of the exports of textiles, spices, gems and other goods to the Fatherland, and the subventions or contributions from the Company's headquarters in Holland, which were received in times of revenue deficits, the Government had funds in Amsterdam, which it wished to transfer to Colombo. This it did through the sale of bills on Amsterdam. After the reform of 1768 the rate at which they were sold was the official rate of 80 stuivers a ducatoon plus a commission of 11 per cent.¹ The bills were bought by the public servants and merchants who had remittances to make to Europe. Bills were also sometimes sold on Batavia, against goods sent on behalf of the Batavian Government to Holland or supplied to Batavia.

V. *Currency Inflation*

But the currency could not be maintained in this position for long. Never permanently free from budgetary difficulties,—since 1729, barring the term of office of van Imhoff, the annual expenses had exceeded the revenues,—the Anglo-Dutch War (1780-84) had rendered worse the financial position of the Government. Though hostilities had terminated by the Peace of Paris in 1784, and Trincomalee, taken in 1782, had been restored to the Dutch by the treaty, the garrisons were maintained. When van de Graaff succeeded Falck, in 1785, Bertolacci tells us, he found the 'Treasury exhausted by the additional number of troops, which the company had been under the necessity of raising, since the year 1780'. Bertolacci continues: 'To obviate these difficulties he for the first time in Ceylon, issued a paper currency. This consisted of treasury notes, called *credit brieven*, payable to the bearer on presentation, in Ceylon copper coin at the rate of 48 stuivers for each

¹ Bertolacci, p. 78.

rix-dollar'.¹ The lowest denomination of the notes being 50 rix-dollars, they were not meant to replace copper. Also they were freely convertible at the Treasury on demand. But inflation could not long be delayed. In the autumn of 1785, half-larins in the shape of small bars of copper valued at $4\frac{3}{4}$ 'Indian' stuivers, and 'boezeroeken' of an alloy of $\frac{2}{3}$ tin and $\frac{1}{3}$ lead, to pass at one duit each, were struck, and depreciation soon raised its head. In 1786 gold and silver exchanged at a premium of 10 per cent. The premium on gold and silver went up, when debased duits of an alloy of lead, tin and tutenag were issued into circulation. In March 1791, the rupee was worth a rix-dollar, i.e. copper money depreciated by about 38 per cent.

Restoration of peace in 1784 and the treaty of 1788, between the British and the Dutch, had not improved the finances of the Government. Increased military expenditure and the demands of the Madura trade proved a great drain on their resources. Cultivation of cinnamon in the Company's territory with a view to make it independent of Kandy in the supply of the commodity, encouragement of the cultivation of rice, introduction of new crops like sugar cane, and similar schemes, though helpful, could not bring sufficient relief. Owing to the activity of counterfeiters, the full amount of the revenue from debasement did not come into the Company's Treasury. Lead duits and larins of copper were effectively forged, and, of the latter, half in circulation were found to be false in 1792. Budgetary difficulties led to further issues of paper and depreciation.

Under these circumstances, consequent upon the establishment of the Batavian Republic in Holland, by the French Revolutionaries, England declared war on the Republic, and the East India Company took the opportunity to attack and annex Ceylon.

¹ Bertolacci, p. 80.

CHAPTER III

THE BRITISH PERIOD I

I. *The Early Measures of the British*

THE transfer from the Dutch to the British (February 16, 1796) was effected through negotiation, van Angelbeek, the Governor, having accepted the terms offered by the officers commanding the British troops. When the British arrived in the Island, the monetary circulation comprised, almost wholly, depreciated paper of two descriptions: kredit brieven, the lowest denomination of which was five rix-dollars, and kas-nooten¹ of denominations ranging from Rd. 1 to Rds. 5. Silver had long disappeared from circulation. Copper, which was a token, had remained behind for some time. But, when premiums began to appear on it also, it too, went into the melting pot, was hoarded or was carried to India.

Under the terms of the Capitulation of Colombo the new rulers had agreed to honour the outstanding kredit brieven.² These, along with the kas-nooten, they decided, gradually, to withdraw from circulation. As there was no other currency to take their place, this meant that the British had to build a new currency system of their own for the Island. To begin with, however, it was proposed to allow Indian money into circulation and, in order to facilitate this, by Proclamation dated June 8, 1796, rates of exchange were fixed between Ceylon and Indian money. *Pagodas* were valued at 45 (Ceylon) *fanams*, 180 stuivers or $3\frac{3}{4}$ rix-dollars. Arcot rupees were rated at one rix-dollar each, the pice ($\frac{1}{18}$ rupee) at one stuiver and the $\frac{1}{2}$ pice at $\frac{1}{2}$ stuiver.³

¹ See p. 81 below.

² Article 6.

³ Codrington, p. 146.

With the return of normal trade relations between Ceylon and the mainland, which had been disturbed for some time, money began to flow into the Island in payment of its surplus exports. But private importations of currency having proved insufficient to meet the demands of the circulation, the Government imported, early in 1799, 30,000 *pagodas* worth of Indian copper¹ and applied to the Company in Madras for additional supplies in the following year.² But the administration was not slow to discover that minting coins locally, rather than importing them from India, would be a profitable undertaking. In April 1801, therefore, they minted *fanams*, *half-fanams* and *stuivers*, all of copper, of a total value of Rds. 48,000, by private contract, at the rate of 37 *stuivers* to one pound of metal. They had a bullion value of 75 per cent of their face value.³ In 1802, whole, half, and quarter, *stuivers* of a lower intrinsic value, and worth about Rds. 9500, were also imported from the Royal Mint in England.

But copper alone could not satisfy the demands of the community. *Kredit briefen* were now no longer in circulation. Most of them had been withdrawn and cancelled by 1800, and the few outstanding ones were treated as Government bonds by the holders. Consequently, there arose a demand for a suitable media of exchange to take their place in the larger transactions for which copper was inconvenient. Frederick North (1798-1805) therefore issued, in March 1800, currency notes of the value of Rds. 30,000, convertible into copper, on demand, at the Treasury, in denominations of Rds. 25 and upwards. The success of the issue induced North to make a further issue of Rds. 45,000.⁴

It remained to satisfy 'the want of some circulating medium less cumbersome than copper' to meet the require-

¹ Despatch of February 26, 1799. ² Despatch of February 30, 1800.

³ Despatch of December 15, 1801. ⁴ Despatch of February 18, 1801.

ments of transactions of less than Rds. 25 in value. Therefore, in 1803, double, single, and half, rix-dollars of silver were minted, by private contract, in February and June. Both dollars had a pure silver content of slightly over 127 grains, i.e. their intrinsic worth (1s. 6d.) was about 70 per cent of their face value, at the price of 5s. 2d. per standard ounce of silver.

II. *Currency Inflation*

But the Government does not seem to have had before its mind any well-conceived plan for currency issue and the amount of the issue soon overshot the mark. The ease with which the community had absorbed the early issues of copper and paper, probably, led North to believe that, the appetite of the Colony for consuming currency was insatiable. When he arrived in the Island its finances were in a precarious condition. The Treasury was nearly exhausted and he had to face a succession of deficit budgets. When the Island was taken over by the Crown in 1802, the new administrative and judicial arrangements entailed considerable additions to expenditure. Before his efforts to balance the budget could bear any fruit he was overcome by the Kandyan War. Notwithstanding the increase in the Debenture Debt, and the increased credits allowed to the Government of Ceylon in Madras, Calcutta and London, there always remained a gap between revenue and expenditure. He filled it partly by issuing tokens and partly by increasing the note issue. From 1801 to 1805 the deficit amounted to £1,393,896 of which £93,761 was covered by the issue of paper currency.¹ At first the notes as well as the coins met a genuine want of the community, but they soon exceeded the demand and exchanges began to decline.

¹ Colvin R. de Silva, *Ceylon Under the British Occupation, 1795-1833*, Part III (MS.), pp. 610 et seq.

The sale of bills on London and India, which it was the practice of the Government to issue from time to time, as their amount was limited by the requirements of the Government, could not hold in check currency depreciation. The official rate soon got out of touch with the market rate, which followed an independent course. In June 1796, the latter had been above the Government rate of 45 *fanams* or Rds. $3\frac{3}{4}$ per Star *pagoda*. Thereafter, as inflation progressed, it steadily rose. It was 48 *fanams* in 1799-1800, at which level it remained until 1802, when the official rate was raised to the market rate. In June of the latter year it rose to Rds. 4.22, in December to Rds. 4.36 and in March 1803 to Rds. 5.¹ At this point it reached the intrinsic value of the rix-dollar.

During the Kandyan War (1803-1805), further additions were made to the circulation, in the form of copper with a lower metallic content, silver rix-dollars and Treasury notes. But further deterioration of the exchanges was prevented for a time by the large sales of bills on Madras and London to meet war expenditure. Sale of bills on London, during the period amounted to £546,058, which was vastly more than the additions made to the note circulation, namely, Rds. 539,005 or £57,361.² Exchanges even showed a slight tendency to rise.

But with the suspension of hostilities in February 1805, depreciation reappeared. Meanwhile the Secretary of State had become anxious about the state of the Island's finances and Maitland (1805-12) had received definite instructions to curtail expenditure and increase taxation. Rigid economies were enforced and the deficit, which, in 1805, had mounted up to £475,000, was brought down to £64,120 in 1806 and was turned into a surplus of £9,624 in 1808.³ Consequently the sale of bills on London and Madras con-

¹ Codrington, p. 148.

² Colvin R. de Silva, pp. 615 et seq.

³ Ibid., p. 622.

siderably dropped and the rix-dollar fell back again to its bullion value. The disparity between the official and the market rates widened, and, as part of the policy to increase the revenue, the Government refused 'any longer to grant bills at a fixed rate of exchange, either on the Presidencies of India or upon England; and ordered them to be sold, by public auction to the highest bidders'.¹ What had hitherto been a private gain was thus transferred to the public revenues.

By now the total volume of the circulation had assumed vast dimensions. Tokens of silver and copper had increased to about 373,600 rix-dollars, and paper currency issue had amounted to Rds. 804,005.² To this must be added, private imports of copper from India as well as Dutch stuivers, 'not an ounce of which had been exported' by January 1800, and presumably, until much later. They were not accepted as money on the continent and, therefore, could not have been taken away by Indian traders. Though the Dutch Treasury notes had been withdrawn, new issues of paper currency were over three times as much in value. In 1805 copper was again minted in Colombo, and also in Jaffna, by private contract.

Bertolacci, however, has argued that the Government was not guilty of inflation,³ as 'no premium could be obtained, nor was demanded, for Ceylon silver rix-dollars, when exchanged for Treasury notes'.⁴ But silver rix-dollars being tokens no premium could appear on them before their value touched that of their bullion content. Till then coins and notes must fall together, one exchanging for the other at par. If depreciation of money were to

¹ Bertolacci, p. 89.

² Colvin R. de Silva, p. 624.

³ Two reports submitted to the Treasury at home, one in 1814 by William Huskisson, the Agent for Ceylon, and the other in 1815 by the Commissioners for Auditing Colonial Accounts in London, also were of the same opinion.

⁴ Bertolacci, p. 107.

continue after this limit was reached, premium on silver was bound to appear, as it did appear in 1812 when the silver rix-dollar fetched 1 to $1\frac{1}{2}$ *fanams* more in terms of the paper rix-dollar. The presence of inflation was reflected in the declining exchanges and rising prices. Exchanges were 20 per cent below par in March 1803, and 40 per cent below par in 1812. Prices rose so high that, Bertolacci considered a rate of Rds. $2\frac{1}{2}$ per *parrah* of rice as the low water mark, on reaching which, as a measure of protection to the local producers, he suggested that an import duty should be levied on rice.¹ Under the Dutch, the famine price of the grain did not exceed Rd. 1 per *parrah*.

Chances of improvement in the exchange position were further destroyed by two successive lean years (1806 and 1807)² which showed passive trade balances. Throughout the period, as well as part of 1808, the rix-dollar stood at its intrinsic value of five to a Star *pagoda* and occasionally even lower, by 1 or $1\frac{1}{2}$ *fanams*.³ Between 1803 and 1808, therefore, the currency was no longer on an artificial standard. It had become a silver standard.

After 1805 silver began to leave the Island and but little of it remained in circulation in the latter half of 1808. In February of the latter year, 'with a view to preventing the export of the . . . coin',⁴ fresh issues of rix-dollars with a reduced fineness of ten-twelfths, but of the same weight as of June 1803, namely, 140 grains, was authorized and in 1808 and 1809, Rds. 692,159 worth of them were put into circulation.⁵ At the price of 62d. per ounce of standard silver, their bullion value was 1s. 4.4d. per rix-dollar. Simultaneously, the old policy of issuing notes to cover budget deficits, which once again reappeared, was resumed

¹ Bertolacci, p. 135.

² Ibid., pp. 93 and 101.

³ Ibid., p. 110.

⁴ Ibid., p. 94.

⁵ Ibid.

and Maitland increased the note issue by Rds. 524,511 during his term of office.¹

As a consequence, in 1809 the Star *pagoda* rose to 63-4 *fanams*, notwithstanding the improvement in the trade balance, which remained favourable during the years 1808 to 1810.² Silver, old as well as new, continued to be exported and, with it, the oldest and heaviest copper of 37 stuivers to the pound. By 1811 hardly any silver was to be seen in circulation, copper was becoming scarce, and the currency consisted of chiefly paper. As the export of copper was causing 'very considerable inconvenience and distress . . . to the internal trade,' by Regulation 5 of 1811, their export was forbidden in quantities exceeding 50 *fanams*. Exchange deterioration continued during the following two years, due to severe and prolonged drought, which turned the trade balance once more against the country. Excess imports rose from about 354,000 rix-dollars in 1811, to nearly 1,500,000 in 1812, and was about 3,467,000 in 1813.³ In July 1812, a bill on Madras fetched 68 to 70 *fanams* a Star *pagoda* and later 75 to 80 *fanams*, when nearly all copper had been smuggled out of the country. And, notwithstanding the depreciation of sterling about this period,⁴ at the close of 1813, no good bills on London could be purchased at less than Rds. 18 to a pound sterling, or 1s. 1½d. to a rix-dollar.⁵

III. *The Improving Tendency of the Currency Position*

By now the effects of inflation had, apparently, worked themselves out fully and exchanges, though still unsteady,

¹ Colvin R. de Silva, p. 624.

² Bertolacci, pp. 110-11.

³ Ibid., p. 111.

⁴ The Hamburg exchange in 1813 was 30 schellings and 6 groates the pound sterling. See Feavearyear, p. 215.

⁵ Bertolacci, pp. 95 and 96. The Ducatoon which was valued at 80 stuivers in 1780 was now worth 240 stuivers.

did not show any further tendency to slip downwards. On the contrary, they showed signs of steadying themselves. No additions had been made to the metallic currency since 1808, and new issues of paper currency, since 1805, were largely for replacing the old notes.¹ The net increase in the paper circulation during the seven years ending with 1811 was about Rds. 100,469 less than the issues of 1802 and 1804. With the return of rains, agriculture had begun to improve, Maitland's land policy and his 'un-remitting attention to the increased cultivation of paddy' were beginning to bear fruit, and trade was reviving. Consequently exchanges were showing a tendency gradually to recover from their rock-bottom level. This was accompanied by increasing scarcity of metallic currency, as during the period of inflation, practically all silver and copper had disappeared from circulation.

To relieve the stringency, observed a Minute of the Governor dated July 16, 1814, 'no better expedient has presented itself than that of following the measure lately adopted by the Mother Country of issuing tokens'. The reference was, probably, to the issue in July 1811, by the Bank of England, under similar (though not identical) circumstances, of tokens of 3s. and 1s. 6d., and in August, of the trader's tokens for 6d. and 1s.² Following this example silver '*fanam* tokens',³ 16 of which were intrinsically worth a rix-dollar, were issued in Ceylon to pass current at 12 to the rix-dollar. They were to be 'receivable at the General Treasury and Cutcheries of the Island' at this rate. By September 1815, 2,095,467 *fanams*, (worth Rds. 174,622.3), were issued. Unlike the earlier issues, since they supplied a real want of the community, *fanam* tokens remained in circulation and retained their

¹ Bertolacci, p. 116.

² Feavearyear, p. 192.

³ They were struck at a mint established by Bertolacci in 1811. See Bertolacci, p. 94 n.

token character. Metallic currency, which had been exported or had disappeared into private hoards, gradually returned, and the monetary circulation, though still chiefly of inconvertible paper and subsidiary coins, included a 'great variety of monies of gold, silver, and copper as well as those coined in other parts of India as those coined and circulated by the Authority of British Government'.¹

In 1815, double, single, and half, stuivers of copper of the total value of Rds. 200,000 were struck at the Royal Mint out of the demonetized Tower half pence, and Rds. 37,339 worth of Dutch *challies*, to serve as fractional money to the *fanam*. By Regulation 3 of 1815, the Dutch *challies* were rated at 12 to the *fanam*. The Kandyan War of 1815, and the rebellion of 1817-18, did not reverse the improving tendency of the monetary system, as both were brought to a speedy conclusion and their cost was met by the importation of specie. In 1815, the rix-dollar had recovered to five to a Star *pagoda* and four to a Porto Novo *pagoda*. It remained at this level until 1819, when, following the withdrawal of martial law in Kandy, it improved to 54 *fanams* to a Star *pagoda*.

Subsequently, improvement in the exchanges was continuous. Paper currency, which, in 1820, had totalled Rds. 2½ millions, was reduced to Rds. 1,561,669 by 1825. One rix-dollar notes were all withdrawn in August 1823. Meanwhile, the demand for currency was increasing as a result of the economic development of the Island which had set in. Insufficient silver in circulation had led to the importation by the Treasury in 1822, on behalf of the Commissariat, 400,000 rix-dollars struck at the Royal Mint, London. Coins also flowed from India to take the place of the paper currency which was being withdrawn. In March 1823, the new Madras quarter rupee² and in December of the same

¹ Regulation 12 of 1814.

² *The Ceylon Gazette*, March 22, 1823, p. 345.

year the new Madras rupee,¹ both countermarked with a Crown (to distinguish them from Madras money), were declared 'current and lawful money of this Island' by Proclamation, at 4 *fanams* or $\frac{1}{3}$ rix-dollar, and $1\frac{1}{3}$ rix-dollars, respectively. Before the close of 1824, Rds. 562,337 worth of them were imported.² In 1825, the rate at which bills on London could be bought remained at Rds. 15 to the pound sterling, or 1s. 4d. per rix-dollar.

The currency trend in Ceylon, during this period, presents a remarkable similarity to that of the bank restriction period in the mother country. Almost from 1796, expansion of the note issue and exchange depreciation, in the two countries, moved more or less together. Exchange on Madras was the lowest in the Colony about the middle of 1812, while, in Great Britain, the Hamburg exchange touched the low water mark in 1811. Thereafter, restriction in the note issue, and improvement in the exchange, continued generally on similar lines in the two countries. And, as if to make the comparison complete, Ceylon had in Bertolacci the counterpart of Vansittart and other apologists of the policy of the Bank of England. Like them, as seen above, he argued that the Government was not guilty of inflation and that exchanges were merely a question of the balance of trade. Currency unsettlement, however, continued in Ceylon long after stabilization was effected in Great Britain. In both countries stabilization was followed by deflation. This similarity in the currency movements of the two countries was, probably, due to the natural tendency on the part of those responsible for moulding the currency system of Ceylon, to follow currency changes in Great Britain, and to draw upon British currency experience, with which they must have been quite familiar.

¹ *The Ceylon Gazette*, January 3, 1824, p. 1.

² Codrington, p. 151.

IV. *The Treasury Minute of 1825*

Being preoccupied with the war and thereafter with the question of stabilization at home, the Imperial Government could not pay sufficient attention to the monetary problems of the Colonies. Their currencies were left to be moulded by 'pressure of temporary emergency, or with views of local and peculiar expediency'.¹ But with the successful resumption of specie payments at home in May 1821, which terminated about a generation of the bank restriction period, and after all opposition to the settlement of 1819 had died down, the Imperial Treasury thought it expedient that steps should be taken to establish a uniform system of coinage in all the Colonies. In many Colonies, chiefly American, the currency system comprised 'cut' and 'plugged' coins, and dishonest paper, and demanded drastic reform. Unsound systems of local currencies had made necessary continual shipments of specie, amounting to several millions, to the Colonies to pay the troops and officials, who drew their salary from the Imperial Exchequer.

These several factors² provoked the Treasury to issue a Minute dated February 11, 1825, recommending the adoption of British subsidiary silver as standard money, to the exclusion of every other currency, in all the Colonies. The Minute led to an Order in Council dated March 23, 1825, giving effect to its provisions. The Order in Council as well as the terms of the Minute were enforced in Ceylon, as directed by the Secretary of State,³ by Regulation 8

¹ Treasury Minute of February 11, 1825.

² The real justification for the measure, however, which was but vaguely felt at the time, lay in the disintegration, after a period of three centuries, of the universal dominion of the Spanish dollar, into rival currency areas, the chief among which was destined to be the sterling area. After 1820, the issues of the coin, which had been the standard coin in several Colonies, varied greatly in weight and fineness and failed to command the same popularity as the older issues.

³ Despatches No. 11 of March 14, 1825 and No. 33 of May 18, 1825.

of 1825, dated July 4 of the same year, and a Government Advertisement issued along with it.¹ The Regulation contained the following provisions:—

1. All Government accounts and transactions shall be expressed in British denominations of pounds, shillings, pence and farthings.

2. British silver coin shall be unlimited legal tender in the Colony, and British copper, legal tender up to 12d.²

3. Silver rix-dollars, issued from the Royal Mint, in 1821, and paper rix-dollars shall be 'received and taken' at 1s. 6d., the copper *fanam* at 1½d., the half *fanam* at ¾d., the pice at ⅓d., the half price at ⅙d., and the Dutch *challie* at ⅓d.

4. Copper coins shall be legal tender up to 8 *fanams* or 12d.

The Advertisement announced that 30 days' sight bills on London would be sold at the Treasury 'every Monday, betwixt the hours of Eleven in the forenoon and Two in the afternoon', for any sums whatever, but not less than £100, at a fixed rate of £100 sterling for £103 of either British silver money or local currency, namely, paper or silver rix-dollars. This was designed to prevent, as the Treasury Minute had explained, British silver from being re-exported to Great Britain. If disbursements on behalf of the home Government required any sum beyond the amount received by the Treasury, in payment of the bills, the Governor was free to negotiate his bills for Spanish dollars, rupees or any other coin, at the best terms which he could obtain.³

The coins so collected were to be issued to the troops at

¹ Supplement to the *Ceylon Gazette*, July 5, 1825, p. 984.

² By a Proclamation issued on the same day the Madras rupee and the Madras quarter rupee, which had been declared 'lawful money' two years back, were demonetized. See *Ceylon Gazette*, loc. cit.

³ Despatch No. 11 of March 14, 1825.

2s. 1d. the sicca rupee, 1s. 11d. the Bombay and Surat rupees,¹ and other coins at their intrinsic value calculated with reference to a price of 5s. 2d. per standard ounce of silver. If the bills sold were to exceed the disbursements in Ceylon on behalf of the home Government, the overdrawn amount was to be made good by remittances to the Colonial Agent in London.²

The reform of 1825 proved an utter failure in Ceylon as in other Colonies. Its effects were as mischievous as they were intended to be beneficial. The valuation of the silver rix-dollar and the rupee was based on the obscure bimetallic mint ratio dating back to 1601 and was 2d. per ounce higher than the gold price of silver in the open market, i.e., the coins were overrated by $3\frac{1}{3}$ per cent³ in relation to British subsidiary silver, which were gold standard coins. This was fatal to the Imperial scheme, as it loaded the dice against the circulation of British currency. The fixed rate for the sale of bills was another obstacle to its success. It failed to take note of the wide range of fluctuation in the rupee-sterling exchanges in India and the possible consequences of such fluctuation on the monetary circulation of Ceylon, as a result of the sale of bills by the Treasury at a fixed rate of 3 per cent premium.

To begin with, the state of the exchanges, in 1825, was not favourable to the introduction of British silver in the Colony. A £100 worth bill on London fetched in the market, at the time, Rds. 1500. The Advertisement put down the official rate at Rds. 1373.4.⁴ Consequently, no

¹ These were the valuations of the rupees in the schedule to the Treasury Minute of February 11, 1825.

² Despatch of March 14, 1825.

³ At the market price of silver the intrinsic value of the silver rix-dollar was 1s. 3½d., that of the Sicca rupee 2s., and that of the Bombay and Madras rupees 1s. 10d.

⁴ Despatch of July 26, 1825, *Monthly Literary Register*, N. S., Vol. II, p. 235.

difficulty whatever was experienced in disposing of sterling bills to meet in full the requirements of the Government. It was no longer necessary for the Treasury to import coins from Great Britain, as had been the case for some time past. The eagerness for the bills increased, when, in September 1827, the rate for £100 worth of bills was reduced from £103 to £101 10s. Between 1825 to 1833 bills worth £1,521,784 were disposed of.

While the policy failed to achieve its object, it forced on the Island severe deflation. The sale of bills on London withdrew currency into the Treasury. Notes from among them were cancelled outright, first of denominations of Rds. 5 and above and later, in the autumn of 1830, those of Rds. 2 and Rd. 1. Paper in circulation shrank from Rds. 1½ millions in 1825 to £87,427 (Rds. 1,165,693½), of which £32,000 (Rds. 42,666⅔) was with the Public Accountants. The object of withdrawing the smaller notes was to make room for British silver. But British silver would not take their place. It never came into the Island on private account. Such quantities of them as did arrive were imported at Government expense. But, as in other Colonies, they were disappearing as fast as they were being introduced. They went back to Great Britain. Nor could Indian or Spanish coin *freely* fill the void, though large numbers of rupees had found their way into circulation. The Governor had express instructions to discourage their use.¹

The Government were in a cleft stick. They represented to the authorities at home that, in view of the continued drain of silver, in order to prevent scarcity of metallic money, it was very necessary that remittance of coin of about £10,000 worth should be made annually.² But the Imperial Treasury was not prepared to go so far to see

¹ Despatch of December 20, 1832 and Despatch of October 10, 1827. *Monthly Literary Register*, N. S., Vol. III, pp. 1 and 53.

² Despatch of December 20, 1832.

British silver circulate in the Island. It, therefore, directed that, Indian and foreign gold and silver coins be issued into circulation at their intrinsic value based upon the price of 5s. sterling per ounce troy of standard silver.¹

There now arose another difficulty, which assumed an acute form in 1836. The ability of the Government to sell bills on London depended upon the state of the Calcutta exchanges. In 1834, 1835, and part of 1836, the rupee-sterling exchange in Calcutta was such that it was less expensive to buy sterling in Calcutta than at the Colombo Treasury. The Government, therefore, had to negotiate their bills in India and import specie from thence. Early in 1836, the original position was restored as a consequence of six months' sight bills on London rising to a premium of $4\frac{1}{2}$ per cent, in terms of rupees, at the price of 5s. per ounce of standard silver. It was now less expensive, for Indian businessmen, to make remittances to Europe by importing rupees into Ceylon, exchanging them for local currency at current rates, and buying Government bills at 30 days' sight, at the fixed premium of $1\frac{1}{2}$ per cent, than by purchasing exchange bills in the Calcutta market or exporting silver.

Not long afterwards, however, the tide turned again. Calcutta exchange on London rose to 2s. od. and 2s. $0\frac{1}{2}$ d. per Company's² rupee or the rupee was at a premium of 9 to 11 per cent in terms of sterling. Ceylon businessmen now found it less expensive to make remittances abroad by shipping rupees to Calcutta and buying sterling in the Calcutta market, than by purchasing bills from the Government at $1\frac{1}{2}$ per cent premium. The Government, therefore,

¹ Treasury letter to the Colonial Office, June 22, 1833, *Monthly Literary Register*, N. S., Vol. II, p. 54.

² The Madras rupee of 180 grains of silver of $\frac{11}{16}$ ths fineness was adopted as the standard rupee for the whole of India by the Coinage Act, 1835. Thereafter this rupee was known as the Company's rupee.

was obliged to import rupees from India at their own expense. They were in the unenviable position of having to purchase rupees in Calcutta at 2s. od. or 2s. 0½d., against their bills on London, and issue them out to the troops, the civil service, etc., at 1s. 10d. Nor would the rupees, imported at such expense, remain in the Island. They were taken back to Calcutta as fast as they were being issued, to purchase more bills.

Export of rupees led to scarcity of money. The real cause of the trouble, however, was not clearly seen at the time. It was imagined that the difficulty of retaining the coin in the Island was due to its under-valuation as compared with its value in the exchange market. Accordingly, in an effort to induce the coin to stay in Ceylon, the rating of the rupee was raised to 2s. od. by a Minute of the Governor dated September '26, 1836. The Minute, although it reduced to some extent the loss to the Government on account of the importation of rupees, proved entirely powerless in arresting the export of the coin to India. For this to be done it was necessary that the bills should be sold in Ceylon at the export point of the rupee to the full extent of the demand whenever it arose.

But it had a far-reaching effect upon the monetary circulation of the Island. The intrinsic value of the rupee being 1s. 10d. the Minute over-valued the coin by about 9 per cent, which sufficed to drive all other coins out of circulation. Such silver rix-dollars as had remained current soon disappeared and the rupee became the 'sole standard measure of property' and 'with its sub-divisions the chief metallic currency of the Colony'.¹ This was the culmination of the attempt to establish in the Colony the currency of the United Kingdom. A series of mistakes proved inimical to the Imperial scheme and produced the assimilation

¹ *Sessional Paper I of 1869*, p. 10.

of the currency of Ceylon to that of India. The only reminders of the misguided policy were a few British copper coins, which continued in circulation for sometime, and the British denominations of money, which persisted for several generations and the echoes of which are still, sometimes, audible at this distance of time.¹

The great gold discoveries of Australia, in 1851, following as they did those of California, had profoundly affected the currency of most of the British Colonies, in common with the rest of the civilized world. But they left the monetary system of Ceylon practically undisturbed. The supremacy of the rupee was not affected by the declaration of the English and Australian sovereigns as unlimited legal tender by the Orders in Council of 1852 and 1856, respectively.² Due to the over-valuation of the rupee, sovereigns never entered into active circulation. English sovereigns, probably, never reached the Island, and the Australian ones, which were occasionally diverted here while on transit to Great Britain, were treated as merchandise, being sold at premiums varying from $\frac{1}{2}$ to 10 per cent, according to the demand for export to India or for turning into ornaments.³

The Order in Council of 1852, in effect, repealed that portion of the Order in Council of March 23, 1825 and Regulation 8 of the same year, which had declared British silver coins unlimited legal tender, although no express allusion was made to these enactments. For, it limited the legal tender quality of these coins to 40 shillings after the fashion in the United Kingdom. The Order in Council was passed in the belief, which was then general, that

¹ In the country-side and among the working classes in the towns today the 50c. piece is generally called a shilling.

² The Order in Council of 1852 was enforced in Ceylon in May 1853, and that of 1856, in July 1857.

³ *Sessional Paper I of 1869*, p. 11.

Ceylon, along with India and other eastern countries, would pass on to a gold standard. But Sir Robert Horton's Minute of 1836 proved an insurmountable obstacle.

Although the rupee with its subdivisions remained the chief currency of the Colony, public accounts continued to be kept in British denominations of pounds, shillings, and pence. The example of the Government was followed by the mercantile community in 1842.¹ The practice also spread among a section of the public, though the great majority preferred to keep their accounts in the old denominations of rix-dollars, *fanams*, and *challies*, or the Indian denominations of rupees, annas, and pies. Dealings in the bazaar, however, were more commonly expressed in 'pounds' and 'shillings'. Contracts in these denominations were universally discharged in rupee currency, each rupee being rated at 2s. 'A debt of two shillings', wrote Sir Hercules Robinson, in 1865, 'is paid with a rupee, and whenever a pound is specified, ten rupees are understood to be meant'.² Pounds and shillings, as the terms were used in Ceylon, did not represent British currency. Connection of Ceylon money with the latter had ceased, when the Advertisement for the sale of sterling bills had become inoperative, consequent upon the disappearance of the legal tender currency from circulation. The Ceylon pound was a silver pound, which was no more related to the British monetary unit than silver was to gold. Its sterling value depended, like that of any silver standard money, upon the gold price of silver. At the price of 5s. per standard ounce troy of the metal, £100 sterling was worth Rs. 1066½ or £106 12s. 8d. in Ceylon money.

¹ *Sessional Paper I of 1871*, p. 6.

² *Sessional Paper I of 1869*, p. 11.

CHAPTER IV

THE BRITISH PERIOD II

I. *The Order in Council of 1869*

ALTHOUGH the Indian rupee, with its subdivisions, had become, by usage, the standard money of the Island, its currency had no other authority than the Governor's Minute of 1836. The Minute did not constitute the rupee a legal tender, an Order in Council, or a local Ordinance, approved by the Crown, being necessary for the purpose. The legal position was unaltered by the acquiescence of the home Government to the Minute, as that was no substitute for a properly constituted enactment. Legally speaking, therefore, obligations contracted in denominations of sterling money, could be redeemed only by the tender of British silver, in sums below 40 shillings, silver or paper rix-dollars, at the rate of 1s. 6d. per rix-dollar, Treasury notes and English or Australian gold. The Government, however, could scarcely refuse, with fairness, to accept its revenue in the coins specified in the Minute. Perhaps, they could also determine, by mere executive notification, the coins in which their own troops and public servants will be paid. But the public at large was not obliged to accept rupees in discharge of debts.

As a safeguard against possible embarrassment, the principal bank in the Island, the Oriental Bank Corporation, had issued its notes in rupee denominations. But the notes of two other banks of issue were still expressed in 'pounds' of the 'currency of the Island'. The legal advisers of the Government were of the view that the holders of these notes could, if they pleased, enforce redemption of them in the legal currency of the Island.

None of the legal tender currency, however, was in active circulation. British silver had been exported, silver rix-dollars had disappeared, paper rix-dollars had been called in and cancelled, Treasury notes had been treated likewise,—only about £1000 worth of them were outstanding in 1866, which, probably, were not really in existence,¹—and gold coins never formed any appreciable part of the circulation, at any time. Being at a premium they were treated as bullion.

This anomalous and unsatisfactory position was brought to the notice of the Committee appointed in June 1847 by Earl Grey, Secretary of State for the Colonies, to report on the financial position and prospects of Ceylon. The Committee's opinion on the question was that, 'as Ceylon is for commercial purposes a part of India, the simplest and the most effectual mode of remedying the present anomalous state of things would be to establish in that Island the Indian in place of the British currency'. But no action appears to have been taken by the home Government on this recommendation.

Attention was drawn to the subject again by Sir Hercules Robinson in 1866. The danger of the position was indicated by the demand made upon the Government, by a discharged official, for the payment of a large amount, in sovereigns, instead of in rupees. This had an effect somewhat similar to the announcement of Lord King, in 1811, that, 'for the defence of his property', he would no longer receive, from his tenants, in payment of their rents, depreciated Bank of England notes, but only gold coins. The position taken by Lord King had provoked the promulgation of the Stanhope Act (1811), which, for all practical purposes, had declared the Bank of England notes as legal tender.² In Ceylon, the demand of the official

¹ *Sessional Paper I of 1869*, p. 8.

² Feavearyear, pp. 190-92.

ultimately resulted in the declaration of the rupee as the exclusive legal tender. The Governor made it the occasion to submit to the Secretary of State, with the approval of the Executive Council, a lengthy Minute,¹ in which he urged the necessity of introducing without any avoidable delay the following measures of reform :—

1. To declare the 'Silver Rupee of India of 180 grains' weight and $\frac{11}{12}$ ths fineness, and its silver subdivisions of proportionate intrinsic value, consisting of the $\frac{1}{2}$ rupee (8 annas), $\frac{1}{4}$ rupee (4 annas), and $\frac{1}{8}$ rupee (2 annas)', as 'the only legal tender of payment'.

2. To repeal the Orders in Council of 1852 and 1856 by which British and Australian gold coins were made legal tender.

3. To repeal Regulation 8 of 1825 and Regulation 8 of 1827, which had made paper and silver rix-dollars and sterling Treasury notes legal tender.

4. To declare that 'all contracts and engagements in force' expressed in denominations of British currency shall be payable in rupees at the rate of 2s. per rupee.

5. To keep 'all public accounts of the Colony . . . in rupees, annas, and pie, instead of, as at present, in pounds, shillings, and pence'.

6. To declare the copper coin in circulation,—namely, British pennies, half-pennies, and farthings, $1\frac{1}{2}$ d. worth of which passed for 1 anna, the *fanam*, the stuiver, and the *challie*, which in like manner, passed for the anna, $\frac{1}{4}$ anna, and $\frac{1}{8}$ anna, respectively,—as 'a legal tender of payment for any sum not exceeding half a rupee', at the current market rates.

7. To introduce, in due course, 'a local token currency . . . to take the place of the *fanam*, stuiver, and *challie*, and representing, like them, the anna, quarter anna, and twelfth of an anna.'

¹ *Sessional Paper I of 1869*, p. 8.

It took over three years of correspondence between the Imperial Treasury, the Secretary of State for Colonies and the Government of Ceylon, before these proposals could bear fruit. They were embodied, with the exception of No. 5, in an Order in Council and Proclamation dated June 18, 1869. Sir Hercules Robinson, however, held in abeyance the enforcement of this Order in Council until he could include in it proposal No. 5 on which, opinion in Ceylon, was sharply divided. To examine the question of the necessity and the desirability of it he appointed a Commission under the chairmanship of George Lawson, Acting Puisne Judge, in September 1869. The Commission itself was divided on the main issue of the denominations in which to keep public accounts. The controversy was heightened by the introduction, which was done in a memorandum of dissent by four members, of a fresh bone of contention, namely, the question of decimal coins subsidiary to the rupee. The Colombo Chamber of Commerce and a section of the public were for maintaining the *status quo* while the Governor and his supporters would not only have the rupee, in place of the pound, but also decimal subdivisions of it, instead of annas and pies. At first the Lords Commissioners of the Treasury aligned themselves against the Governor. They turned down his proposals more than once. But, in the end, they yielded to his persuasion.

The proposals regarding the decimal coins, and the denominations in which public accounts were to be kept, were embodied in the Proclamation and Order in Council of 1869. They were brought into force on January 1, 1872. In 1874, by Proclamation of March 17 of the same year, by which time sufficient supplies of decimal coinage were available, the old British and Ceylon copper were demonetized. The $\frac{1}{8}$ rupee was similarly treated in 1891 and, in the following year, the $\frac{1}{2}$ rupee and the $\frac{1}{4}$ rupee were

made subsidiary coins with a five-rupee legal tender limit by Order in Council. The old denominations, however, were never completely effaced. In the towns, as well as in the country-side, small dealings fractional to a rupee are still frequently expressed in shillings, *fanams* and *challies*.¹ Similarly, fees of advocates and physicians are paid and received in 'guineas', a 'guinea' representing Rs. 10.50.

II. *The Swettenham Currency Commission, 1893*

Interest in currency problems was revived once again in 1884, when, on the failure of the Oriental Bank Corporation, a Government note issue was set up. We shall review this in the following chapter. Nine years later, chiefly due to the adverse effect, on their finances, of a depreciating rupee, the Government of India closed the mint to the public. To inquire into the effects of this on Ceylon and to suggest any suitable course of action in order to protect the interests of the Colony, the Governor appointed, in October 1893, a Commission under the chairmanship of J. A. Swettenham (later Sir Alexander Swettenham).

The Commission was of the view that the depreciation of the rupee in terms of gold currencies, during the preceding quarter of a century, had, on balance, benefited the Colony.² It had not proved embarrassing to the business community. The prosperity of the European firms was bound up with that of the planting industry and they shared in the benefits of the vast progress which the industry was making. The sea-borne trade of the Island had

¹ The values in cents of these denominations are as follows :—

1 shilling (Tamil, *śilin*) = 50 cents.

1 *fanam* (Tamil, *panam*) = 6 cents.

1 *challie* (Tamil, *salli*) = $\frac{1}{2}$ cent.

The 25c. piece passes for 5 *fanams*.

² *Sessional Paper VI of 1894*, para. 25.

increased considerably. It had risen from Rs. 85.36 millions in 1871 to Rs. 138.20 millions in 1892, or by about 60 per cent. The rise had, more or less, kept pace with the depreciation of silver (see TABLE I). Since 1888, tea, which had taken the place of coffee, had become worth to the producer almost as much as coffee had been worth, in the days of its greatest prosperity. The value of other commodities exported had more than doubled, during the preceding fifteen years, and, measured in gold, the increase was about 60 per cent. Depreciation of the rupee had not led to any decline in the imports either. They had increased by about 47.9 per cent. There was also a commensurate increase in the shipping calling at Colombo. These brought the merchants and traders sufficient business and profits, more than to counteract the harassing influence of a constantly fluctuating exchange.

Nor was the Government badly hit. Public revenue had increased to Rs. 18.51 millions in 1892 from Rs 10.64 millions in 1871 (see TABLE I). Though, in the meanwhile, Government's annual disbursements, in sterling, had risen from £181,944, the average for 1871-73, to £376,583, in 1893, and had correspondingly increased the number of rupees required to meet them, the increase in the revenue had enabled the finances of the Colony to bear the enhanced claims without embarrassment.

But, apparently, the Commission had misread the causes of the Island's prosperity. They attributed it wholly to the depreciation of the rupee, and imagined, as had been done by the planting interests in India, that a change-over to the gold standard might greatly jeopardize production and trade. Although, undoubtedly, the fall in the exchange did play a part, the Island's prosperity was due to more fundamental factors. British enterprise and British capital, which had been flowing into the Island, at an ever-increasing pace, were opening up the country

TABLE I

FOREIGN TRADE, RUPEE-STERLING EXCHANGE RATE,
SHIPPING CALLING AT CEYLON PORTS, AND THE
REVENUE OF CEYLON FROM 1871 TO 1892

(Amount in million rupees — Shipping in million tons)

Source: *The Report of the Silver Currency Commission*
(Sessional Paper VI of 1894)

Year	Imports	Exports	Total Trade	Average ex- change rate for six months' light bills	Tonnage of shipping entered and cleared ¹	Revenue of Ceylon
				s. d.		
1871	47·98	38·38	85·36	...	1·64	10·64
1872	51·70	32·87	84·57	2 0 ⁰⁰ / ₃₂	1·82	11·75
1873	55·74	56·16	111·90	1 11 ⁰⁰ / ₃₂	1·99	12·91
1874	56·92	49·24	106·16	1 11 ⁰⁰ / ₃₂	2·02	13·24
1875	57·19	59·37	116·56	1 10 ¹⁵ / ₃₂	2·22	14·44
1876	59·34	49·51	108·85	1 9 ¹⁵ / ₃₂	2·32	14·68
1877	62·78	63·05	125·83	1 9 ¹⁵ / ₃₂	2·50	17·03
1878	53·13	49·37	102·50	1 8 ²¹ / ₃₂	2·56	16·46
1879	53·65	54·54	108·19	1 8 ¹⁵ / ₃₂	2·61	14·75
1880	53·48	52·79	106·27	1 8 ²³ / ₃₂	2·91	13·85
1881	47·12	38·38	85·50	1 8 ¹⁵ / ₃₂	3·07	13·69
1882	46·62	39·88	86·50	1 8 ⁰⁰ / ₃₂	3·21	12·16
1883	48·31	39·59	87·90	1 8 ¹⁵ / ₃₂	3 43	12·40
1884	51·32	37·77	89·09	Do.	3·51	Do.
1885	45·13	40·08	85 21	1 7 ¹ / ₂	3·56	12·65
1886	47·86	38·82	86·68	1 6 ³³ / ₃₂	3·92	12·68
1887	50·31	43·99	94·30	1 5 ²³ / ₃₂	4·14	13·44
1888	58·52	46·00	104·52	1 4 ²³ / ₃₂	4·45	15·41
1889	60·70	54·79	115·49	1 4 ⁷ / ₈	4·83	15·30
1890	63·09	57·67	120·76	1 7 ¹ / ₈	5·12	16·23
1891	66·64	65·50	132·14	1 5 ²⁸ / ₃₂	5·70	17·96
1892	70·69	67·51	138·20	1 31 ⁹ / ₃₂	5·79	18·51

¹ Figures in this column are taken from the *Ceylon Blue Book*, 1894.

with the assistance of Indian labour. New companies and new estates were springing up. The high dividends, which they declared, did not rest upon the failure of wages and costs to rise with the depreciating rupee—wages, in any case, were low and a little upward adjustment of them could not have made any appreciable difference in profits—but were mainly the result of the eminent suitability of the soil for the cultivation of tea and coconut, the rich returns they brought, and the increasing demand for tea from a prosperous consuming public in the United Kingdom. And, later events proved that, the apprehension of the Commission regarding the consequences of adopting a gold standard, in Ceylon, while China, her chief rival in the production of tea, remained on silver, was wholly unfounded.

The increase in the imports, despite the falling exchange, was made possible by the increased spending power of the people coupled with the declining sterling price of manufactures. The latter, generally, fell at a faster pace, and by a much wider percentage, than the depreciation of the rupee. While, in 1893, the rupee had depreciated by about 34 per cent, as compared with its sterling value in 1873, the sterling price of cotton manufactures, during the interval, had fallen by 31 per cent, sugar by 38 per cent, iron by 60 per cent, petroleum by 74 per cent, and copper by 53 per cent. Consequently, the local prices of practically all these commodities had declined, instead of rising. Consumption of rice increased, notwithstanding the rise in its price from Rs. 2.78 to Rs. 3.75 per bushel, because of the increased immigration of labour, employment, and income.

Though, in periods of rising prosperity, the incidence of remaining on a silver standard, in a gold standard world, may not be clearly visible in the trade statistics, it is, nevertheless, a hindrance to free economic intercourse with the rest of the world, for which exchange stability

is a basic essential. The greatest part of the Island's exports was to gold countries. In 1892, it was Rs. 52.4 millions or 86 per cent of the total exports. It had risen to this figure from Rs. 27.0 millions, or 76 per cent of the total, in 1883. The major portion of the imports, however, came from silver countries. It was Rs. 26.2 millions, or 67 per cent of the total, in 1883, and Rs. 43.7 millions, or 69 per cent of the total, in 1892. Considering imports and exports together, trade with silver countries was about 42 per cent of the total, in 1892, and about 47 per cent, in 1883. But a good part of the imports came from India so that after India was included among the gold standard countries the share of silver countries in the Island's trade would be negligible. Exports to India and the gold-using countries were Rs. 58.1 millions, or 95.1 per cent of the total, in 1892, and imports from the remaining countries were Rs. 3.1 millions, or 4.9 per cent of the total, in the same year. Considering the two together the percentage share of the trade with the latter group was about 2 per cent. It was clear, therefore, that the interests of the Island lay in joining India, in abandoning silver for gold.

The Commission, however, believed otherwise. But they were not prepared 'to advise the Government of Ceylon to sever its connection with the currency of the Continent of India'. They believed that 'the risks inseparable from such a change (were) as great as, if not greater than, those which may be expected from inaction at the present time'. The Government accepted the recommendations of the Commission and Ceylon currency kept step with the Indian currency, while the latter was being steered towards the gold standard. Exchange and prices in Ceylon followed the vicissitudes of exchange and prices in India during the period of transition (1893 to 1899). Thereafter, both countries settled down to a par rate of 16d. per rupee.

III. *The Gold Ordinance (No. 13) of 1901*

Six years later, to implement the recommendations of the Fowler Committee, the Indian Coinage and Paper Currency Act (1899) was passed by the Indian Legislature constituting sovereigns legal tender. This induced a desire to adopt similar measures in Ceylon as well. The advantages of keeping a portion of the currency reserve in a full bodied coin, such as the sovereign, in place of a coin of artificial value and large bulk, such as the rupee, were at once perceived and permission was sought of the Secretary of State to effect the change. Though the latter did not quite see any point in imitating the Indian reform, he did not find any definite reason why he should turn down the request either. He, therefore, assented and, by an Order in Council, dated September 26, 1901, the sovereign (but not the half-sovereign) was declared unlimited legal tender at the same rate as in India, namely, Rs. 15 the sovereign. To enable the inclusion of gold in the currency reserve the Paper Currency Ordinance of 1884 was amended by Ordinance No. 13 of 1901 (November 6). It permitted the issue of notes in exchange for sovereigns, on demand, but left the convertibility of notes into sovereigns to the option of the Currency Commissioners.

Later events, however, showed that it would have been wiser if the Indian example had not been followed too closely and if the supposed benefits of the circulation of sovereigns, and of keeping them in the reserve, had been foregone. But the desire to be on a par with India was strong.¹ Moreover, the dangers of the step were not then apparent.

It was not perceived that the Gold Ordinance, as the measure came to be called, would lead to an inconveniently large influx of gold. On the contrary, it was thought

¹ See *Ceylon Hansard*, 1903-4, p. 2.

difficult to attract any appreciable amount of it.¹ Indeed, the optional redemption of notes either into silver or gold was inserted in the Ordinance through fear of a run on gold.² It did not occur to any one, that the problem would be one of silver scarcity. The banking interests were pleased at the convenience, which the Ordinance afforded them, of arranging their finance in sovereigns instead of in silver rupees.³ The cost of importing silver from India was $\frac{1}{4}$ or $1\frac{5}{8}$ per cent, while that of importing gold was only $1\frac{3}{8}$ per cent.⁴ It was thus cheaper for the banks to place themselves in funds, in Ceylon, by importing gold instead of silver.

They could also, with advantage, divert to Ceylon Australian gold destined for Europe, in exchange for sterling in London. Tapping of Australian gold, in transit, was a common feature of exchange finance, in India, but the Ceylon banks were unable to adopt the device, except to meet the small local demand for gold. For, though the sovereign was legal tender in Ceylon, the currency authority was not legally obliged to issue notes against them, nor did it, as in India, accept sovereigns as a matter of administrative practice. Hitherto, the only ultimate way open to the banks of converting their surplus purchases of sterling into local money had been to import rupees from India and to offer them to the Currency Commissioners in exchange for notes. But the Gold Ordinance enabled them to do the same by the importation of gold coins, mainly from India, and sometimes also from Australia. Accordingly, silver deposited by the banks with the Commissioners, in exchange for notes, first

¹ *Sessional Paper XXVII of 1903*, p. 3.

² 'Address of the Governor to the Legislative Council', *Ceylon Hansard*, 1903-04, Appendix p. 11.

³ *Ceylon Hansard*, 1901-02, p. 15.

⁴ *Sessional Paper V of 1903*, p. 56.

declined and then ceased altogether. Gold was being offered to them instead. This is revealed by tables¹ II and III below.

TABLE II

RUPEES RECEIVED BY THE CURRENCY COMMISSIONERS
FROM THE BANKS DURING THE YEARS 1900, 1901
AND 1902

Month	1900	1901	1902
	Rs.	Rs.	Rs.
January ...	140,000	65,000	60,000
February ...	110,000	...	70,000
March ...	...	50,000	...
April ...	...	...	...
May ...	225,000	400,000	...
June ...	40,000	1,400,000	15,000
July ...	2,090,000	900,000	...
August ...	1,110,000	700,000	...
September ...	...	550,000	...
October ...	1,700,000	560,000	...
November ...	256,000	580,000	...
December ...	...	20,000	...
Total ...	5,671,000	5,225,000	145,000
Monthly average ...	472,583	435,416	...

While in 1900 and 1901 the amount received by the Commissioners had totalled Rs. 5.7 millions and Rs. 5.2 millions respectively, that in 1902 was only Rs. 145,000 or less than the monthly average for 1900 and 1901. No silver was offered to them after the middle of 1902. Gold was flowing in, in its place, and the net receipts, in 1902, were worth Rs. 6.8 millions.

¹ These tables are taken from *Sessional Paper V of 1903*, p. 9.

TABLE III

RECEIPTS OF GOLD BY THE CURRENCY COMMISSIONERS
FROM THE BANKS AFTER THE COMING INTO FORCE
OF THE GOLD ORDINANCE

Date			Amount	
			£	Rs.
1901				
November	...	...	52,500	787,500
December	...	...	55,000	825,000
1902				
January	...	...	...	...
February	...	...	5,000	75,000
March	...	...	3,000	45,000
April	...	...	53,500	795,000
May	...	...	13,000	202,500
June	...	...	50,000	750,000
July	...	...	91,000	1,365,000
August	...	...	80,666	1,209,990
September	...	...	6,000	90,000
October	...	...	125,000	1,875,000
November 1 to 13	...	...	22,000	330,000
Total			556,666	8,349,990

IV. *The Lascelles Currency Commission, 1902*

When the supply of silver in the reserve declined and that of gold increased, the Commissioners rationed out the former and exercised the option of converting the notes into sovereigns. But the sovereign, which represented more

than a month's wage for the daily worker, was too high a value for the great mass of the population and, therefore, could not replace the rupee in circulation. As in India, it could only replace the ten-rupee note. Sovereigns, therefore, were accepted only to a small extent and there arose a considerable scarcity of silver. To enquire into the question of this scarcity and for 'suggesting some way of meeting the present difficulty and of preventing its recurrence', the Governor appointed, in November 1902, the Ceylon Currency Commission with Sir Alfred Lascelles (then Mr. A. G. Lascelles), Attorney-General, as chairman.

The Commission recognised that the scarcity of silver was due to the Gold Ordinance. Its repeal was an admittedly simple, and certain, solution of the difficulty, as thereupon the banks would be forced to import rupees. The general consensus of opinion of the witnesses who appeared before them, as well as of the public generally, however, was against the demonetization of the sovereign. It was viewed as a 'retrograde step.' The Indian authorities at the time seemed to be making every effort to have the sovereign firmly established in the country. The seriousness with which negotiations were then being carried on made it to appear, that a branch of the Royal Mint might be established in Bombay at any moment. It was too much to expect, therefore, that Ceylon would condemn the gold coin at a time when, in the neighbouring continent, arrangements seemed to be all but complete to enthrone it. The Commission recognised that the sovereign was not in much demand either for local use or for remittance to India. They also admitted that the balance of opinion was that there were not any great prospects of its becoming popular in the near future. Nevertheless, they felt that the sovereign had not been given a fair trial.

They would therefore amend, but not abrogate, the offending section (section 3) of the Gold Ordinance. They would free the Commissioners of Currency from the obligation to issue currency notes in exchange for gold. Such issue must be left to the discretion of the Commissioners. The obligatory surrender of notes must remain only against the tender of rupee coins. This would enable the currency authority to force the banks to import rupees, when there was a depletion of them in the reserve, and a scarcity in circulation. The administration generally agreed with the views of the Commission and efforts were made to stimulate the use of sovereigns by the public so as to support the case for its retention.¹

The Secretary of State, however, was disposed to adopt the view that it would be much better to repeal outright the Order in Council of 1901 and the Gold Ordinance. He recalled that when he had assented to these measures, he had not seen in them any advantage beyond the convenience of the smaller space required for storing gold. If, therefore, experience showed that the balance of convenience was against the acceptance of the sovereign into the reserve, there should be no hesitation in discarding the measures altogether. The Indian example, he was at pains to point out, should not be allowed to influence the currency policy of the Island, to the detriment of its own interests. The necessity, in the case of India, to hold gold in the currency reserve arose out of the obligation to maintain the exchange value of the rupee, and the introduction of it in the circulation of the country, as legal tender, was merely part of this policy. Ceylon being free from the responsibility, there could be no justification for similar consideration being given to the sovereign. If, however, the Governor still

¹ *Ceylon Observer*, March 5, 1903.

adhered to his view, the Secretary of State would not insist upon repealing the measures but would agree to the suggested amendments.

But the Secretary of State's arguments failed to carry any conviction. The Governor reappointed the Commission to examine the Secretary of State's despatch and they stuck to their original position. Accordingly, an Ordinance (No. 6 of 1903) was passed by the Legislative Council (October 31, 1903) to amend the Gold Ordinance, giving the Commissioners full discretionary powers to accept or to reject gold offered to them. But in order to retain the automatic character of the system, an executive notification dated November 13, 1903 decreed that the amount of gold which the Commissioners may hold must not exceed £200,000. These measures sufficed to remedy the problem of silver scarcity.

The period, which followed the successful linking of the Indian rupee to sterling at 16d., brought to the Island, as it had done to India, great prosperity. It continued, until the outbreak of the Great War I, except for a temporary break in the first one or two years of this century, which is attributable to the effects of plague and famine, in India, and perhaps also, to the scarcity of silver. The Island, unlike India, was little affected by the financial crisis of 1907-08. Prices rose, production of tea, and agricultural output generally, increased, and foreign trade made considerable strides forward. Increased business, at higher prices, required larger volumes of currency and the Commissioners were called upon to issue more and more of it. The note issue rose from Rs. 10.60 millions on December 31, 1898, to Rs. 29.93 millions on December 31, 1913. The following table gives statistics of the Island's foreign trade, tonnage of shipping calling at Colombo and other ports, and the volume of note issue, from 1898 to 1914:—

TABLE IV

(Amount in million rupees—Shipping in million tons)

Source: *Ceylon Blue Books* and monthly statements
of the Commissioners of Currency

Year	Imports	Exports	Total trade	Tonnage of shipping entered and cleared	Note issue (December)
1898	97·89	85·37	183·26	7·08	10·60
1899	111·99	101·58	213·57	7·44	14·46
1900	122·34	94·96	217·30	8·49	13·29
1901	112·63	89·91	202·54	9·03	13·21
1902	109·47	99·40	208·87	9·96	13·87
1903	116·26	108·76	225·02	10·32	17·11
1904	116·48	104·27	220·75	11·23	13·80
1905	115·24	102·49	217·73	11·16	13·58
1906	123·50	112·52	236·02	13·30	17·53
1907	129·32	129·57	258·89	13·30	16·77
1908	130·29	130·17	260·46	13·88	15·75
1909	133·78	147·02	280·80	14·01	17·25
1910	164·86	173·72	338·58	15·04	23·41
1911	164·41	182·03	346·44	14·93	23·59
1912	182·00	198·95	380·95	15·42	23·18
1913	199·64	234·86	434·50	16·13	29·93

V. *The Great War I*

The first effect of the war on the Ceylon, as on the Indian, exchange was adverse. The demand for remittances to India, from Europe, through Council bills, in payment of Indian exports abroad, ceased, as the pressure for the movement of funds now turned in the opposite direction. Speculators, fearing a shortage of the supply of manufactured goods, for which India depended upon European countries, placed large orders for them, and the consequent increased imports, reversed the trade balance. Confidence

in the financial soundness of the Government declined and their ability to redeem currency notes began to be doubted. The exchange, however, was prevented from falling below the lower sterling point by the free sale of Reverse Councils. When Rs. 8 millions worth of them were consumed by the market the situation was brought under control and early in 1915 the demand for Council bills revived.

From October 1915, however, the currency authority was faced with a new problem. Indian exports of food, and raw materials of war, were greatly in demand. But Europe could not spare manufactured goods, in sufficient quantities, to buy them with. As the war progressed the excess exports of the country grew increasingly heavy. They could not be paid for in gold, because of the embargo on the export of the metal, or, as in Great Britain, due to the practical difficulty of procuring gold for export. Parts of the exports, namely, those to the Dominions, Colonies, and South Africa, were, in any case, on credit and had to be paid for, in the first instance, by the Government of India. The situation, in the early stages, was met by the sale of Council bills, and the issue of currency in India, in exchange for them. Exports on credit were financed out of the resources of the Government or by raising loans.

This arrangement, however, soon presented insuperable difficulties. As the Council bills could not be redeemed in notes alone, it was necessary to keep sufficient stocks of rupee coins in the reserve. So long as silver was available, and the rupee remained a token, there was little difficulty in meeting the demand for the coin in full. But when, towards the close of 1916, a combination of factors sent the gold price of silver above the melting point of the rupee, this was no longer possible, except at a heavy loss. Rupees in circulation disappeared into the melting pot and the coin reserve fell to a low ebb. The convertibility of the currency note was in danger. The sale of Council

bills, therefore, had to be restricted. At the same time, as Indian exports met a military demand, these had somehow to be financed. The difficulty was met by rationing out Council bills as from January 1917 to the exporters of food and raw materials of war. The rest were largely left to their own resources.

The difficulties of the Indian position profoundly influenced Ceylon, whose problems were similar. The exchange banks in the Island had never experienced any difficulty in the past, in disposing of, in India, their surplus purchases of sterling, when they required funds in Ceylon. But when they found the Indian market possessing large, unsaleable, stocks of it, and the Secretary of State, unwilling freely to issue Council bills against them, they were faced with a problem which was new to the Island, and which came without any appreciable amount of warning. The Government of the country, however, was as anxious as the Indian Government, to give assistance to the exporters and the banks. The first step they took was to convert Rs. 1.5 millions of their balances in Ceylon into sterling Treasury bills through the banks, which, thereby, were enabled to reduce, by an equivalent amount, their holdings of sterling. As the pressure for the transfer of funds to Ceylon continued unabated, this was followed in December 1916 by an issue to the exchange banks of currency notes of Rs. 3 millions in exchange for sterling drafts on London, which were also to be invested in Treasury bills.¹

The result of it, however, was that, while the cash in the currency reserve fell below the legal minimum of 50 per cent additions were made, at the same time, to the investment reserve by Rs. 3 millions, the amount of the Treasury bills bought. Before the issue of the additional notes,

¹ *Ceylon Hansard*, 1917, p. 12.

paper in circulation had amounted to Rs. 30,327,000 and the coin reserve had consisted of Rs. 15,165,000,¹ or a trifle above the legal ratio. The new notes rendered the coin reserve short of the minimum by about Rs. 1,486,500. This by itself need not have been a cause for much concern, as the law had provided for such diminution of the reserve, subject to certain restrictive conditions. But the simultaneous addition to the securities was illegal. It constituted a breach of the proviso to section 17 of the Paper Currency Ordinance.

The difficulty, which had led to this breach, however, still remained substantially unrelieved and the Commissioners of Currency were unwilling to purchase any further sterling drafts. But on a representation being made to them by the banks, they undertook to issue to the latter Rs. 6 millions, in notes, in return for £400,000 in gold to be placed to their credit in England.² The offer was too tempting to be turned down. For, it promised to extricate the Commissioners from the predicament in which they had unwittingly landed themselves. The addition of the gold to the reserve would raise the cash ratio comfortably above the statutory minimum. Its location in England would not have caused any difficulty: the Ordinance did not lay down that the coin reserve must be held in Ceylon. The notes were issued in January 1917, and the Currency Commissioners credited to the coin reserve the promised gold, and the statement of accounts for the month, consequently, showed a surplus reserve of about Rs. 12 lacs, as against a deficit of about Rs. 15 lacs in the previous month. Apparently, the Commissioners had taken the ability of the banks to provide them with gold quite seriously.

The banks, however, were unable to put down gold in England. Though the convertibility of the Bank of

¹ *Ceylon Hansard*, 1917, p. 12.

² *Ibid.*, p. 13.

England notes had not been formally suspended, nor an embargo placed on the export of gold, there were formidable practical difficulties on the way of procuring gold or of its being taken out of the country, except by, or on behalf of, the State. The public were appealed to from all directions, in Parliament, in the press, by the Bank of England, and by the commercial banks, not to ask for gold. They were told that, the person who did so was helping the enemy.¹

In face of this determined drive against the exercise of the right of convertibility, the Commissioners were left with no option but to accept credits at the Bank of England, in place of gold. This they did with the approval of the Secretary of State. Thus, instead of relieving them of their difficulties, the transaction took them deeper into it. Little hopes now remained of rectifying the illegality of the position. It was, therefore, decided to approach the Legislature to indemnify the Commissioners for the acts done in good faith, and, at the same time, to take powers to tide over the emergency. This was done by Ordinance No. 1 of 1917, which became law on March 3 of the year.

VI. *Ordinance No. 1 of 1917*

The Ordinance, which had a far-reaching effect, included the following important amendments to the principal Ordinance² :—

1. It suspended, with retrospective effect, as from December 30, 1916, the proviso to section 17 of the Ordinance, which prohibited additions being made to the securities in the reserve when the specie part of it fell below fifty per cent of the note issue, and section 13, which limited the investments held in the reserve to one-half the amount.

¹ Feavearyear, p. 304.

² For a discussion of the provisions of the principal Ordinance see pp. 91-93 below.

2. It empowered the Currency Commissioners to issue notes, with the approval of the Secretary of State and in amounts to be sanctioned by him, against credits at the Bank of England, as if such credits represented sovereigns.

3. It authorized the issue of one- and two-rupee notes, which were to be unlimited legal tender.

The proviso to section 17 of the Paper Currency Ordinance suspended by item (1) above, could be restored and the power, under (2), abrogated, by order of the Governor, notified in the *Government Gazette*. Authority under (3) was meant to reduce the pressure of demand, for purposes of internal circulation, of rupee coins, the use of which had to be economized, and was in a line with the policy pursued in India of issuing Rs. 2½ and Re. 1 notes.

In June 1917, the Indian Government prohibited the melting of gold and silver coins and banned their export from the country, in order to relieve from further embarrassment an already much embarrassed currency authority and to prevent a drain of the gold and silver resources of the Empire, which had to be conserved to purchase essential war imports. Under express direction from the Secretary of State,¹ a similar enactment (Ordinance No. 33 of 1917) was passed by the Ceylon Legislature on October 3, 1917.

The rise in the price of silver caused further embarrassment in 1918, when it reached the melting point of subsidiary silver. These, as a consequence, disappeared into hoards or into the melting pot, giving rise to scarcity of small change. By Order in Council dated May 8, 1919, therefore, their millesimal fineness was reduced from 800 to 550. The new coins were put into circulation on September 1, 1919. Later, subsequent to the change of policy in India with regard to it, the sovereign was demonetized in Ceylon, by Order in Council, as from August 7, 1920. When the

¹ *Ceylon Hansard*, 1917, p. 330.

Government of India raised the statutory exchange rate to 2s. gold, on the recommendation of the Babington Smith Committee, the Ceylon rate was raised to the same level, as from October 1, 1920. When India lowered it, in April 1923, to 1s. 4d., Ceylon did the same on October 1 of the same year. It again followed India to the 1s. 6d. rate on October 1, 1928, to which the Indian rupee had been raised in the previous year.

The raising of the rate to 2s., in October 1920, created a very difficult situation. Revaluation of the sterling assets in the currency reserve, at that rate, showed a drop in their value of Rs. 6.07 millions,¹ which caused an excess note issue of Rs. 3.5 millions over the total currency assets. Simultaneously, the cash reserve fell below the legal minimum by Rs. 12.14 lacs. The situation was rectified in April 1922, partly by a contraction of the note circulation but mainly out of the 'profits' of Rs. 2.76 millions² realized on the sale of securities. These were valued in the books of the Commissioners at the rate of 2s. per rupee, which was much higher than the market rate.

The exigencies of the war had also caused two similar situations, which amounted to a breach of either the letter of the law or an administrative notification. The amendment of 1917 had expressly stated that sterling credits, to be included as part of the coin reserve, must be credits at the Bank of England. But the Commissioners do not seem to have adhered to this provision too strictly. From July 1919 these credits were shown as 'Cash at call in L. C. W. and Parr's Bank', in the monthly statements of the Commissioners, and were reckoned as part of the coin reserve. But, strictly speaking, not being credits at the Bank of England, they could not be regarded as equivalent to

¹ *Report of the Colonial Auditor, 1920-21, para. 120.*

² *Report of the Colonial Auditor, 1921-22, para. 161.*

sovereigns. Before July 1919 the corresponding item was described as 'Coin in England'.

Similarly, so long as the Notification of November 1903 was not withdrawn, it was not quite regular to include in the coin part of the reserve more than £200,000 (Rs. 3,000,000) worth of sovereigns or, after the 1917 amendment came into force, more than equivalent sterling credits at the Bank of England. But it was not until February 1920, that the notification was withdrawn¹ and, in the meanwhile, sterling credits, which were included in the minimum reserve, had remained at Rs. 6 millions or Rs. 7.9 millions.

¹ *Government Gazette*, February 6, 1920

CHAPTER V

PAPER CURRENCY

I. *Dutch Paper Currency*

As noted in a previous chapter, paper currency was first introduced into Ceylon by the Dutch in 1785. It was occasioned chiefly by budgetary difficulties of the Government and partly by the scarcity of gold and silver coins. The Batavian Government had set a precedent, three years ago, under similar circumstances and the possibilities of success were already demonstrated by the free circulation, among the public, of certificates of safe custody, which, before the hostilities, it had been customary for the cashiers, or their accountants, at Colombo, to issue against the moneys lodged with them. Copper coins, which were the chief media of circulation commonly available, were inconvenient for large payments, for which the certificates were found to be eminently suitable, especially in disturbed times when the carrying of cash in large amounts was not safe.

The first issue of paper currency was dated May 10, 1785. As already noted elsewhere it took the form of Treasury notes, called kredit brieven, and were expressed in rix-dollars. The amount issued totalled Rds. 25,000 and was in denominations of 50, 100, 500 and 1000 rix-dollars. The notes were convertible, on presentation at the Treasury, in copper at the rate of 48 stuivers a rix-dollar. They passed current by endorsement like cheques and, judging from the last issue, which was taken over by the British, in 1796, bore interest at the rate of 3 per cent per annum. Like the cash certificates, which preceded them, they met a real demand for purposes of larger exchange transactions and were readily absorbed by the community.

The Government, pleased at the prospect of this easy solution of their financial difficulties, followed up the first issue by two more, before the close of the year, one in October, which included denominations of 20, 10, and 5 rix-dollars, and the other in December. The authorized amount of issue for the former was Rds. 28,000, and for the latter Rds. 30,000. In 1786, a further issue of 25,000 rix-dollars worth of notes was authorized. By now, however, inflation had set in and gold and silver exchanged for a premium of about 10 per cent. In the following year, the issues of 1785 were recalled and cancelled. But as fresh notes of the value of Rds. 72,000 were put into circulation the volume outstanding remained more or less stationary.

In 1788, the situation was rendered worse by the issue of nearly Rds. 120,000, which more than doubled the amount in circulation. The premium on silver, in consequence, went up. For the next two years the additions to the circulation were less rapid, the total issue being Rds. 15,000. But this was followed by an issue of over Rds. 56,000 in 1791, which sent the silver ducatoon to 120 stuivers or a premium of 50 per cent. The capital levy or a 'liberal gift' of two per cent on the movable and immovable possession of the Company's subjects, imposed in 1792, probably, explains the small issue of notes, in that year (Rds. 5,210), as well as the absence of any net additions, in 1793. In December of the latter year, kredit brieven bearing dates prior to September 1, 1792, were recalled and exchanged for new notes or copper coins, as many of them were found to have been falsified by alteration of the figures. Political tension having necessitated large military expenditure, the year 1794 saw, what was, probably, the largest issue of notes in any one year, namely, over Rds. 538,000.

After the fall of Trincomalee and Jaffna in August, and September, 1795, respectively, and the threatened investment of Colombo, confidence in the ability of the Govern-

ment to redeem kredit brieven, which for some time had been in doubt, was lost. There followed a 'flight' from the notes, as a result of which the silver ducatoon rose to 150 stuivers and even copper exchanged at a premium. Hitherto, as stuivers were tokens like paper, the two had been falling together, but when the intrinsic value of the copper coin was reached, the latter could fall no further. Depreciation of paper, however, had no such limit.

The war led to the issue, 'for the convenience of the public', of another class of notes called kas-briefjes or kas-nooten (currency notes) in denominations of 1, 2, 3, 4, and 5 rix-dollars. They were redeemable in the same way as kredit brieven, in copper, but, unlike them, were not required to be endorsed, while passing from hand to hand. The Plakkaat dated December 18, 1795, which announced the issue of kas-nooten, prohibited, at the same time, the exchange of copper at a premium in terms of kredit brieven. They were ordered to be accepted at their face value. But payments expressed in gold and silver could be claimed at the prevailing premiums on the two metals. The Plakkaat only hastened the disappearance of the metallic currency. The issue of kas-nooten raised the premium on copper and silver, which were swept out of circulation before the capitulation of Colombo.

Neither the kredit brieven nor the kas-nooten had any specific reserve backing. They were regarded as a liability on the general revenues and other assets of the Government. Like Government loans, they were issued when the Government was 'in want of ready money'.¹ Under the terms of the Capitulation of Colombo the kredit brieven outstanding, (Rds. 468,750 of which only about half were in active circulation), were withdrawn and cancelled by the British by 1800. The same treatment was extended to the kas-nooten as well.

¹ Article 6 of the Capitulation of Colombo.

II. *The Early Issue of Paper Currency under the British*

The first paper currency issued by the British was dated March 1800. It was meant for use in the larger exchange transactions and was issued in denominations of 25, 50, and 100 rix-dollars. Like the kas-nooten these notes bore no interest and were 'made exchangeable at the Treasury for their amount on Demand', in copper, at the rate of 48 stuivers a rix-dollar. The first issue was of the total value of Rds. 30,000. 'The convenience and utility of these notes were soon perceived', wrote North, 'not only by the Europeans but the native inhabitants of the Colony'. This induced him 'to make a further issue to the extent of 45,000 rix-dollars, making in all Rds. 75,000'.¹ On account of their superior convenience to copper, in making payments, they commanded a small premium in the market. But, as noted in a previous chapter, financial difficulties soon led to over-issue and depreciation.

By about 1812 the effects of inflation had worked themselves out and exchanges steadied themselves. Currency issue thereafter remained within limits set by the improvement in agriculture and trade. Between 1813 and 1820, the note circulation rose from somewhat under Rds. 2 millions to over Rds. 2½ millions, but exchanges showed definite improvement.

III. *Policy of the Home Government with regard to Paper Currency in the Colonies*

The home Government, however, was, on principle, opposed to State note issues and had made known their prejudices in this regard quite early.² They would not permanently tolerate Government issues in the Colonies. Ceylon was, therefore, directed to pursue a policy of

¹ Despatch of February 18, 1801.

² Despatch of January 23, 1813, *Monthly Literary Register*, N. S., Vol. II, p. 8.

gradually withdrawing paper currency as the financial circumstances of the Island permitted. The process began in 1820. By Regulation 5 of 1823, one-rix-dollar notes were withdrawn and cancelled: they were exchanged for silver rix-dollars or notes of higher value. By 1825 the note issue, as a result of this policy, fell by Rds. 866,016 to Rds. 1,561,669. The decision to introduce British subsidiary silver as the currency of the Island made it necessary to pursue this policy further so as to clear the way for the coins. All small notes had therefore to go. Accordingly, the Secretary of State directed the Governor of Ceylon gradually to withdraw all the rix-dollar notes and to apply the surplus revenues for the purpose.¹

But the pursuance of this policy was beset with great difficulties. Sir Edward Barnes pointed out that, apart from the question of financing the procedure, the withdrawal of over $1\frac{1}{2}$ millions of rix-dollars worth of notes would paralyse all exchange transactions. He thought it inadvisable to reduce the paper currency below the equivalent of £80,000 (about Rds. 1,000,000). He was personally of the view that, instead of reducing the note circulation, the rix-dollar notes should be replaced by notes expressed in sterling denominations of £50, £25, £20, £10, £5, £2, £1, 10s. and 5s.

The Imperial Treasury seemed to be satisfied that wholesale withdrawal of notes was unpractical as well as dangerous. But they would not change their mind on the question of the smaller notes. They, therefore, authorized the issue of £100,000 worth of sterling notes of not less than £1 but on the express condition that, before any of the pound notes were put into circulation, at least an equivalent amount of rix-dollar notes were cancelled.²

¹ Despatch of March 14, 1825.

² Despatch of March 23, 1826, *Monthly Literary Register*, N. S., Vol. II, p. 265.

In the aversion to the smaller notes, the home Government and the Imperial Treasury were influenced by several considerations. Opinion was then unanimous in Great Britain that the crisis of 1825 was almost wholly due to the over-issue of notes below £5 by the hundreds of country banks and Parliament, by the Act of 1826 (March 22), had decreed that all notes below £5 must go, the Bank of England's as well as the others.¹ There was also before the Treasury the experience of the indiscriminate private issues of notes below £1 of half a century ago.² Unrestricted issue had likewise disorganized the currency systems of several Colonies, chiefly American. Subsequent to the policy of popularizing British subsidiary silver in the Colonies, the weight of these factors was reinforced by the consideration that notes below 20s. might prove prejudicial to the currency of the British coins.³ At the same time it was recognised that a limit of £5 was too high for an eastern people, the great majority of whom counted their income in units which approximated to a shilling. Also, exception had been made from the operation of the 1826 Act in the case of Scotland, where the banks were permitted to issue £1 notes. A higher limit could not reasonably be insisted upon for Ceylon, a vastly poorer country. The Scottish precedent was, therefore, permitted to be followed in the Island.

Sir Edward Barnes, however, made yet another effort in defence of the smaller notes, reinforcing his case by the report of a committee which he had specially appointed to look into the question. The Committee, *inter alia*, pointed out that nearly half the paper in circulation consisted of

¹ Feavearyear, pp. 161-62. .

² Despatch of April 2, 1827, *Monthly Literary Register*, N. S., Vol. II, p. 267.

³ Feavearyear, pp. 223-24.

notes of the value of 15s. or less and that their withdrawal would cause great hardship. But the Lords of the Treasury remained adamant. Meanwhile by Regulation 8 of 1827, £90,000 worth of sterling notes were issued into circulation while, Regulation 9 of the same year, provided for the withdrawal of rix-dollar notes except the two- and five-rix-dollar ones. These were cancelled gradually and, in December 1832, the entire circulation of £87,427 was made up of sterling notes.

Meanwhile, in the wake of the peaceful progress which had followed the close of the Napoleonic wars, banks were springing up in the Colonial Empire to meet the demand for credit for the development of its resources. And, in connection with the grant of royal charters or the allowance of Colonial acts of incorporation for the banks, the Imperial Government had gradually evolved a banking policy. It was first formulated about 1831 by Lord Althorp, then Chancellor of the Exchequer, and by Paulett Thomson (afterwards Lord Sydenham), who was then at the Board of Trade. In the formulation of it they were, doubtless, influenced by the discussions which had followed the resumption of specie payments in England.

The accepted theory of banking in England, prior to the promulgation of Peel's Bank Acts of 1844-45, presumed the issue of notes by the banks. Deposits being then of quite secondary importance, at any rate in the Colonies, notes furnished the chief inducement to establish banks, and were the chief source of banking profits. As a result of the recurring crises, particularly the crisis of 1825, however, opinion was widespread in the country that unregulated private bank notes were a source of perpetual danger to economic stability. Regulation of note issue, therefore, figured prominently in the Colonial banking policy. In order to avoid misconception of the views held by the home Government in this regard, on the request of the Colonial

Office, the Treasury drew up, in concert with the Board of Trade, an abstract of such regulations as they thought indispensable. These were transmitted to the several Colonies by Lord John Russell in a circular letter dated May 4, 1840, for their information and guidance.

The abstract regulations,¹ in so far as they related to note issue, were as follows: (1) The notes should be cashed, on demand, in specie, at the place of issue, as well as at the principal establishments of the issuing bank. (2) No notes should be issued under £1 or its equivalent in any other currency. (3) The note issue and other liabilities of the bank must not exceed thrice the amount of the paid-up capital of the bank plus deposits in specie or Government paper. (4) The bank must publish periodically (half-yearly or annually) returns of its assets and liabilities, made out in a form which was appended in a schedule to the regulations. (5) The liability of the shareholders was to be twice their holding of the shares.

Portions of these regulations were incorporated in Ordinance No. 23 of 1844 by which the Government sought to extend the privilege of issue to private banks. It authorized the Colonial Treasurer to grant licences to banks wanting to issue notes. They were to be given free to such of them as had a royal charter or letters patent, but to the others, on payment of a fee of £20 per annum. A separate licence was to be taken in respect of every town or place of issue, but no bank was to be obliged to take out more than three licences, whatever the number of places where it might issue notes. The notes issued were subject to a composition fee of 3s. 6d., in lieu of stamp duty, payable half yearly, for every £100 worth of notes issued out or lying in the bank's reserves. Notes were to be in denominations of £1 and upwards and, statements, showing

¹ R. Chalmers, *A History of Currency in the British Colonies*, London, 1893, pp. 429-31.

the note circulation on the Saturday of every week, were to be submitted, once every half year, to the Treasurer. The latter was also free to examine the books of the bank or call for additional information whenever he might deem it necessary. The Bank of Ceylon, founded in 1841, and the Western Bank of India, assumed the right of issue under this Ordinance.

With the passage of Peel's Acts of 1844-45, the regulations of 1840 were revised, in 1846, with a view to bringing them into full accord with the principles of the former. The revised regulations, apart from improved provisions relating to banking proper, introduced new principles governing the issue of paper currency, framed mainly on the lines of the Imperial provisions relating to English commercial bank notes. The maximum of issue was 'not at any time to exceed the amount of the Capital Stock of the Company actually paid up' and the power of issue was to be exercised 'in such manner only as shall not be at variance with the general law of the Colony'. Subsequently, an important addition was made to these regulations. It required a 'reserve of specie always to be maintained equal to one-third of the amount of notes at any time in circulation.' The Governor was authorized to have the books of the banks examined from time to time in order to assure himself that the reserve provision was observed. These provisions were applied to the charters of the Oriental Bank Corporation (1851), and the Chartered Mercantile Bank (1858). But as a special case, the banks were allowed to issue, in Ceylon, but not elsewhere, notes of the value of 10s. and 5s. Apparently, the Imperial Treasury had relaxed the rigour of its old prejudice against the smaller notes.

By Ordinance No. 2 of 1861, which came into operation in January of the following year, the right of issue was limited to chartered banks and could be extended to others only by a special local Proclamation. The licence fee of

£20, payable by non-chartered banks, was abrogated, and the composition fee was raised to 10s. on every £100 worth of notes.

When the bank notes became available for circulation, the Treasury at home saw less reason for the continuance of the Government note issue, which had always been an eyesore to it. As we have seen, it had never willingly allowed such issues in the Colonies. In the case of Ceylon, the Cape, and British Guiana, it had acquiesced because, the paper currency in these Colonies had been an inheritance from the Dutch. In the case of some others, like Jamaica (1822) and Prince Edward Island (1825),¹ the Treasury had similarly agreed to State issues due to proved financial exigencies. But it had never been sparing in its efforts to withdraw the issues. The Imperial Government's faith in their policy was considerably reinforced by a Memorandum on the subject, submitted in 1854, by James Wilson, the well-known Treasury official. He re-affirmed, on theoretical as well as on practical grounds, the soundness of the policy.

Renewed instructions were, therefore, sent to Ceylon to take steps to cancel the notes without any avoidable delay. Effect was given to this by a Minute of the Governor dated December 28, 1855.² The withdrawal of the notes was accompanied by a notification that the notes of the chartered banks would be received at all the Cutcheries precisely as the Treasury notes had been received hitherto.

The important banks of issue in the Colony, at the time, were the Oriental Bank Corporation and the Chartered Mercantile Bank. The former was one of the largest banking institutions, in the East, and by far the largest institution, in Ceylon. Its note circulation, in the Island, in March 1884, amounted to Rs. 32.11 lacs, or rather more than three-fourths of the total note circulation. The notes

¹ Chalmers, p. 35.

² *Sessional Paper I of 1869*, p. 8.

of the Chartered Mercantile Bank totalled Rs. 9.21 lacs. Comparatively little coin being current, bank notes were the chief media of circulation.

IV. *The Failure of the Oriental Bank Corporation*

The failure of the Corporation, therefore, in May 1884, was bound to give the Island's economy a thorough shaking. When its notes were put out of use, there ensued a state of panic, and trade almost came to a complete stand still. Unless some speedy action was taken, food riots on the estates were feared, as rice could not be had from the traders except for silver, which was very scarce. Popular confidence, in paper currency, having been shaken there was a pressure on the Chartered Mercantile Bank also for the immediate conversion of its notes, and the danger of its crashing, too, appeared imminent. The supply of silver currency at the disposal of the Government being small—the greater portion of their balances was with the defunct Corporation—the Postmaster-General directed that post office orders should not be cashed by the post offices. Apprehending general suspension of payment the Bank of Madras and the Chartered Mercantile Bank, who were later joined by the Chamber of Commerce, made representations to the Government to guarantee the notes of the Corporation, which, they emphasised, was the only way of escape from the crisis. It was pointed out that the Government could not shake off their moral responsibility to come to the rescue of the community: they had retired from the field, to make room for the notes of the two banks and had expressly stated so.

Partly under pressure of these representations and partly out of the conviction that speedy action on their part alone could prevent a general stampede, the Government, on May 5, guaranteed the notes of the bankrupt Corporation. The guarantee produced the expected results. The notes,

which for a time had fallen to 50 per cent discount, quickly regained acceptability in the bazaars, and the ten-rupee notes changed hands at but a discount of a few cents.¹

Subsequently, with a view to prevent recurrence of similar calamities the Governor, on the suggestion of the Bank of Madras, implored the Secretary of State to establish a State note issue in the Island on the Indian model. The sentiments of the home Government on the subject, however, had never been left in doubt. The Lords of the Treasury had always preferred private issues and had opposed, with great persistency, State issues. Perhaps the only Colony with a Government paper currency at the time was Mauritius, in whose case they had been presented with a *fait accompli* and had, thereby, been compelled to make an exception (1849). Even so in 1857-58 they had made an earnest, though unsuccessful, attempt to restore the issue to private hands.² In 1854 they had rejected proposals for a (secured) Government issue in Prince Edward Island.

It was not to be expected, therefore, that, on the failure of a bank in Ceylon, the authorities, at home, would be disposed readily to discard the doctrines to which they had tenaciously adhered for so long a time. The first reaction of the Lords of the Treasury to the news from Ceylon was one of indignation. They informed the Secretary of State that the Governor had acted *ultra vires* of the standing orders, which required him to refer all matters relating to currency to the Secretary of State before taking any action, and that they were not prepared to endorse the guarantee given by him. But the Secretary of State, after an initial noncommittal attitude, had, in the meanwhile, decided to assent to the *fait accompli* which he had been presented with. And, on second thoughts, the Lords of the Treasury realized that this decision was tantamount to admission of

¹ *Sessional Paper I of 1886*, p. 2.

² Chalmers, p. 35.

the principle of State liability for private issues. Apprehending that further catastrophies, like that of the Oriental Bank, might cause timid Governors to seek an easy way of escape from embarrassment by acting on the precedent of Ceylon, they thought it apt to reverse their decision. Subsequently, an Ordinance (the Ceylon Paper Currency Ordinance No. 32 of 1884) drafted by the Colonial Office, generally on the model of the currency law of Mauritius,¹ was passed by the Legislative Council on December 10, 1884. It received the assent of the Governor on December 17 of the same year.

V. *The Paper Currency Ordinance, 1884*

The Ordinance of 1884 entrusted currency issue and management to a Board of Commissioners called the Commissioners of Currency, comprising the Colonial Secretary, the Treasurer, and the Auditor-General. The notes were to be in the values of Rs. 5, Rs. 10, Rs. 50, Rs. 100, Rs. 500, and Rs. 1000 and were to be unlimited legal tender in the Island including payments by the Government of Ceylon. They were redeemable, on demand, at the office of the Commissioners at Colombo, in silver rupees of India. The next two clauses related to the implementing of the guarantee given to the Oriental Bank Corporation notes. The notes were to be exchanged by the Commissioners for the Government issue from February 15, 1885, until March 31, 1885.

From and after April 1, 1885, it was obligatory on the Commissioners to convert Indian rupee coins into currency notes. To enable due redemption of the notes, the Ordinance required that, the Commissioners should maintain a reserve, in silver coin, of one-half, at least, of the amount of currency notes in circulation. The remainder of the notes

¹ Ordinance No. 9 of 1849 and Ordinance No. 8 of 1876.

were to be covered by securities. Not exceeding one half of the latter, except by the express sanction of the Secretary of State, were to be in Government of India stock. The rest could be in such securities of the United Kingdom or of the Government of any British Colony, other than Ceylon, as may be approved by the Secretary of State. The Lords of the Treasury, who were responsible for the exclusion of Ceylon securities, explained that in an emergency, when it may be necessary to realize the assets in order to redeem notes, local Government securities would be, probably, unsaleable on the spot. To hold them in the currency assets, therefore, was not thought to be quite safe.

While, ordinarily, the metallic portion of the reserve was expected to be maintained at 50 per cent of the note circulation, the Ordinance permitted its being reduced to $33\frac{1}{3}$ per cent, subject to the condition that, when it remained below 50 per cent no additions were made to the securities part of the reserve. All the proceeds of the note issue, during such periods, must be kept in silver coins. If, however, the silver reserve fell below $33\frac{1}{3}$ per cent it was binding upon the Commissioners to realize part of the securities in the reserve and convert the proceeds into silver in order to restore the minimum reserve ratio. The income from the security reserve was assigned to the ordinary revenue of the Colony, excepting one per cent of the amount of the investments, which was to be accumulated into a Depreciation Fund, to be maintained by the Commissioners separate from the currency reserve, in order to cover any depreciation in the value of the securities. But the Governor, with the sanction of the Secretary of State, could discontinue partially or wholly the annual accumulations to the Fund, when its amount was deemed to be sufficient fairly to attain its purpose. The Commissioners were required to publish annually, in the *Government Gazette*, a profit and loss account of the currency issue, and a monthly

statement, giving an abstract of the amount of the note circulation, the amount of the silver reserve, and the nominal and market values of the securities in the reserve, as on the 10th day of each month. The notes were given the guarantee of the Government of Ceylon.

The Paper Currency Ordinance did not expressly confer monopoly of issue on the Government, nor did it require termination of the issuing powers by the Chartered Mercantile Bank, to which it made no reference whatever. This was unnecessary. By Ordinance No. 2 of 1861, non-chartered banks were forbidden from issuing notes and chartered banks could do so only on taking out a license from the Colonial Treasurer. It was, thus, within the power of the State to keep off rivals from the field. As for the notes of the Chartered Mercantile Bank it was decided that the issuing powers of the bank should not be renewed on the expiration of its charter in 1888.

The main features of the Ordinance of 1884 have remained intact, though it has been subjected, since then, to six amendments. Reference has been made to some of them elsewhere. But it is convenient to enumerate all of them here. In 1886, by Ordinance No. 12, the Board of Commissioners of Currency was created a corporation with a common seal and perpetual succession under the style of Ceylon Currency Commissioners. By Ordinance No. 13 of 1901, sovereigns were made eligible for inclusion in the specie reserve. It enabled the Commissioners to issue, on demand, currency notes in exchange for them and the notes could be redeemed either in rupees or in sovereigns, at the option of the Commissioners. The working of this amendment having caused a great deal of embarrassment to the authorities, by Ordinance No. 6 of 1903, the Currency Commissioners were authorized to refuse to issue notes against the tender of sovereigns, if such a course was considered expedient. In 1909, by Ordinance No. 11 of that year, the Depreciation Fund was

authorized to be amalgamated with the general Reserve Fund,¹ as the maintenance of two separate funds was considered unnecessary and inconvenient.

By the amendment of 1914 (Ordinance No. 33), a certificate issued by the Treasurer, to the effect that a currency note was spurious on the ground that it did not contain the secret marks appropriate to the note, was made conclusive evidence in all legal proceedings on the subject. The 1917 amendment, which was the last, permitted, as a war measure, the issue of notes against sterling credits at the Bank of England, allowed the reserve ratio to fall to one-third, and authorized the issue of one- and two-rupee notes.

The first abstract statement of accounts, as required by section 20 of the Paper Currency Ordinance, refers to the month ending May 31, 1885.² This, along with one of the recent statements, is reproduced below. The monthly statements represent almost the only material available to the outside critic of the Ceylon currency system.

¹ But in the published statements of accounts the Fund continued to appear separately until July 1919.

² The Ordinance required that the statements should be made out as on the 10th day of each month. But except for the statements referring to the period between December 1904 and December 1909, this rule was not observed. The statements for the period preceding December 1904, as well as those which relate to the period subsequent to December 1909, refer to the position on the last day of each month.

I
[Extract from the *Ceylon Government Gazette*, June 12, 1885]
ABSTRACT of the Account of the Currency Commissioners for the month ending 31st May, 1885, required
by section 20 of Ordinance No. 32 of 1884.

Circulation	Value	Reserve	In Silver	In Security
	Rs. cts.		Rs. cts.	Rs. cts.
Currency notes in circulation	...	By Silver in vault ...	1,283,583 0	...
		„ Silver in the vault to be invested by the Crown Agents ...	292,799 0	...
		„ Securities invested in England, as per annexed Statement ...	...	599,283 2
		„ Invested in Indian Government 4 per cent. paper at 96½ to 97 (the latest known market rates) ..	...	891,500 0
Total ...	3,067,165 0	Total ...	1,576,382 0	1,490,783 2
				3,067,165 2

G. T. M. O'BRIEN, Acting Colonial Secretary,
R. W. D. MOIR, Acting Treasurer,
W. H. RAVENSCROFT, Auditor-General,

} *Currency Commissioners.*

Statement referred to :

Particulars of the sum of £43,600 Stock transferred from Ceylon Surplus Funds to the Trustees of the Ceylon Commissioners of Currency by the Crown Agents for the Colonies.

	Stock	Value at which transferred to Commissioners	Cash
Cape 4½ per cent. Debentures	£ 1,500	£ 98	£ 1,470
Canada Dominion 5 per cent. Debentures	5,500	111	6,105
New South Wales	6,200	101	6,262
Do. do.	1,500		
Do. do.	2,000		
Do. do.	500	109	6,213
Do. do.	1,100		
Do. do.	600		
Do. do.	1,000	109	10,464
Do. do.	8,600	108	16,200
Do. do.	15,000	105	105
Victoria 5 per cent. 1st Jan., 1894	...		
New South Wales 4 per cent. Inscribed Stock	...		
	43,600		
			46,819 = @ 1s. 6½d. Rs. 599,283.02.

II

[Extract from the *Ceylon Government Gazette* No. 8,637 of July 19, 1940]

MONTHLY statement issued by the Commissioners of Currency, under section 17 of the Paper Currency Ordinance (Cap 291) for the month of May, 1940 :—

1.—Note Account

	Rs.	c.		Rs.	c.
Total Stock on April 30, 1940 ...	80,998,557	0	In Vault on May 31, 1940 ...	39,394,557	0
Add Notes received in May, 1940 ...	16,500,000	0	In Circulation on May 31, 1940 ...	55,291,000	0
	97,498,557	0			
Deduct Notes destroyed in May, 1940 ...	2,813,000	0			
Total ...	94,685,557	0	Total ...	94,685,557	0

2.—Reserve Account

	Rs.	c.		Rs.	c.
Notes in circulation ...	55,291,000	0	Securities at Cost (£ 1 = Rs. 13.33)	48,276,162	24
Excess of Reserve over Notes in circulation ...	9,608,892	20	Coin in Vault ...	14,614,667	46
	64,899,892	20	Cash at Call, Madras ...	2,009,062	50
Total ...	64,899,892	20	Total ...	64,899,892	20

3.—Average amount of Notes in circulation during the month.
Average amount of Coin in Vault during the month ...

...	53,418,484	0
...	14,612,719	0

4.—Details of Investments and Securities

	Face Value	Face Value (£1 = Rs. 13.33)	Purchase Value (£1 = Rs. 13.33)	Market Value (Sterling at Rate of the Day)
	£ s. d.	Rs. c.	Rs. c.	Rs. c.
Colonial and other Securities	1,524,012 13 6	20,320,169 0	20,645,286 2	20,794,210 78
National Defence Loan, 3 per cent., 1954/58	100,000 0 0	1,333,333 33	1,290,834 77	1,338,685 12
Funding Loan, 2½ per cent., 1956/61	148,444 13 9	1,979,262 50	1,730,114 94	1,775,172 49
Funding Loan, 2½ per cent., 1952/57	72,419 8 2	965,592 11	906,966 50	923,760 93
Conversion Loan, 3 per cent., 1948/53	170,000 0 0	2,266,666 67	2,269,509 5	2,292,705 87
War Loan, 3 per cent., 1955/59	3,582 9 5	47,766 28	47,766 28	47,719 97
Indian Stock, Sterling	320,539 15 10	4,273,863 89	4,446,706 57	4,343,717 46
Treasury Bills	...	2,000,000 0	1,990,937 50	1,990,937 50
Indian 4 per cent. Loan, 1960/70	...	838,000 0	899,660 42	865,235 0
Government of India 3½ per cent. Loan, 1947/50	...	9,336,000 0	9,365,496 58	9,406,020 0
Government of India 3 per cent. Loan, 1963/65	...	737,900 0	666,394 64	656,731 0
Government of India 4 per cent. Loan, 1943	...	3,782,700 0	4,013,270 86	3,964,742 44
Government of India 4½ per cent. Loan, 1955/60	...	2,800 0	3,218 11	3,038 0
Total	...	47,884,053 78	48,276,162 24	48,402,676 56

C. H. COLLINS, Financial Secretary, } *Commissioners of*
W. L. MURPHY, Deputy Chief Secretary. } *Currency.*

CURRENCY OFFICE,
Colombo, July 12, 1940.

CHAPTER VI

CEYLON BANKING

I. The Pre-commercial Bank Period

IN passing from currency to the allied topic of banking, we come to a part of the subject where statistics and other information are much less freely available. The early history of banking in the Island remains obscure and the present position is not much different. The Government does not publish any statistics relating to banking and exchange banks, which are the chief banks in the Island, have always remained, as in India, a closed book suspicious of all inquiries for information. In their published accounts they do not distinguish between their business in Ceylon and abroad.

Joint stock banking commenced in Ceylon much later than in India. For nearly fifty years after the British occupation there was no bank in the Island. Credit was not available, except at onerous rates from private bankers, and traders and agriculturists had largely to depend upon their own resources. Prior to 1841, when the first bank was opened, business and other remittances abroad and from the outside world to Ceylon used to be made through three principal channels: the Government, the Merchant Houses, and the Chettiairs. Up to about 1830, Government bills on London (if a few Missionary bills drawn upon the parent societies in England, at par, be excepted), were the chief means of remittance abroad. The bills were drawn to transfer funds to Ceylon from the Imperial Treasury, for the maintenance of military and civil establishments, to

balance the almost habitual deficit budgets of the Island,¹ or to meet war expenditure.

About 1830 a few Mercantile Houses were established in Colombo which sold their six months' sight bills upon London at the conventional rate of 8 or 10 per cent premium, and on Madras at rs. 11d. per rupee.² The amount available was limited by the exports of the firms and such additional capital funds which they wished to transfer to Ceylon from time to time. These two channels of remittance primarily served the demands of the economic traffic between the Island and Europe. They were not, however, of direct usefulness, as we shall see presently, to the traffic with India, which was vastly larger.

There was never any dearth of bills in the Island for remittance to Europe. Apart from Government bills there was a large supply of unabsorbed export bills in the market. The exports of Ceylon to Great Britain, the continent of Europe, and America, greatly exceeded imports from those countries, so that the demands of the import trade fell short of the available quantity of export bills. To these sources of credits in London was added the capital inflow into the Island, which began after the Napoleonic wars, seeking investment in the plantations. Consequently, the market was always left with surplus sterling credits.

Trade balance with India, on the contrary, was adverse. This was but natural, as the Island got its supplies of grain, other articles of food, cloth and necessities of life generally, from India, while the range, as well as the volume, of commodities which India could take from her was limited. There was, therefore, a great pressure for movement of funds

¹ From 1801 to 1830, the finances of the Island showed a surplus only in four years, namely, 1808, 1821, 1822, and 1829. Colvin R. de Silva *op. cit.*

² H. D. Andree, 'Banking in Ceylon', *Ferguson's Ceylon Directory*, 1864-65, p. 86.

to India. Direct 'marriage' between the surplus with Europe, which was almost wholly expressed in sterling, and the deficit with India, which was payable in rupees, however, was beset with difficulties. The Chettiar firms, agents of large business houses in Madras and other towns in southern India, in whose hands were centred the finance of the grain trade, did not, as a rule, take sterling bills in payment of their goods. Their willingness to accept them was governed by the state of the demand for sterling exchange in India. Moreover, they did not generally favour bills other than Government ones.

At the same time, merchants were unwilling to see their capital temporarily locked up in bills. They were not prepared to wait until the bills were negotiated in India and rupees imported from thence. This meant a delay of at least a fortnight.¹ Nor could they wait until funds were obtained by the more circuitous method of discounting bills in London, importing bullion into India, offering it to the mint, and shipping the coin to Ceylon. It may have taken as much as an year or more. The Merchant Houses, therefore, were obliged to have agents in the Presidency centres, on whom to draw rupee bills against the proceeds of the sale of sterling bills on London, which they posted to the latter. The Chettians bought the bills on Madras, Bombay, and Calcutta, and supplied the merchants with cash in Ceylon.² Thus the smooth movement of the wheel of exchange depended so largely upon the disposition of the Chettiar merchant bankers. They were in the strong position of being able to compel the holders of sterling credits, to convert them first into rupee bills before they would have anything to do with them.

This was an extremely unsatisfactory state of affairs and was ill-suited to meet the needs of a rapidly progressing

¹ Andree, p. 96.

² Ibid., p. 87.

economy. It was tardy and expensive, and the absence of a satisfactory clearing house of exchange within the country was keenly felt. Coffee plantations, which were destined to become the chief source of income and prosperity, had begun to change the face of the Island, at great speed after 1837, and the Island held out every promise of becoming a centre of considerable commercial importance. In 1825, the value of its foreign trade was £521,000. In 1840, it rose to £1,143,000, or more than doubled in 15 years. Meanwhile there had been no improvement in the facilities for credit and discount. Importers, as well as exporters, had to depend upon Bombay and Madras for the solution of their credit problems. 'The present Traffic is carried on', observed the Papers and Prospectus of the Bank of Ceylon, 'with great inconvenience and difficulty in great degree by *Barter*, or by the indirect and circuitous way of Madras and Bombay, causing loss of time, additional charges, and greatly increasing the unfavourable rate of exchange. There is no place for the Deposit of money or for the safe custody of specie, no means or channels to obtain Discounts or Loans, no matter how good the security offered, and to effect any financial operation, there is no channel except *via Madras or Bombay*'.¹

II. *The First Bank of Ceylon*

In order to remedy this state of affairs, William Thompson, then a merchant in London, who later established business in Colombo and became a member of the Legislative Council, organized Ceylon's first commercial bank, the Bank of Ceylon. Partly owing to the opposition of vested interests and partly because the Island, 'at that period, was almost unknown in London', some difficulty was experienced in raising the necessary capital. It was

¹ Andree, p. 82.

ultimately 'subscribed by parties totally unconnected with the Island'. On receipt of a royal charter the bank commenced operations in Colombo on June 1, 1841 with a nominal capital of £125,000. It soon established agencies in the Presidency towns and opened a branch at Kandy in 1843.

The charter of the bank was based upon the Colonial banking regulations of 1840 which, as noted in the preceding chapter, the Imperial Government had drawn up as a guide to the banking policy to be pursued in the Colonies. The regulations required that the capital of the banks should be specified in advance and that the whole of it should be subscribed within eighteen months of the date of the charter or the act of incorporation. Banks must not commence business before the full amount of the capital was subscribed, and a moiety, at least, paid up. The balance must be fully paid up within a given limit of time, not exceeding two years from the date of incorporation. The banks must not hold their own shares nor advance loans on their security. The discounts or advances to any director or officer of the bank must not, at any time, exceed one-third the amount of its total advances and discounts. It must not advance money on the security of ships, fixed property, or merchandise; it must not own land or buildings, except its own premises, or be engaged in business, except as dealers in bullion or bills of exchange. It must confine its transactions to discounting commercial paper, negotiable securities, and doing such other legitimate banking business. The dividends to shareholders must be drawn out of profits only and not out of capital.

The career of the Bank of Ceylon was short-lived. Soon after it commenced operations the economy of the Island experienced the first coffee boom of the early 'forties. Capital was rushing into the trade from all directions to capture the prodigious dividends which the industry was earning. In the general optimism which prevailed, expense

was under-estimated and returns exaggerated and many planters soon discovered that they had entered into undertakings beyond their means. In the wild race, as to who would plant first and have their estates in bearing, credit was raised at 9 or 10 per cent by mortgaging every available security. Inexperienced estate superintendents 'who had never seen a tree planted, or a crop of coffee prepared for the market'¹ were engaged. Wages of labour and the cost of every article of consumption were raised to an absurd pitch and more than oriental extravagance was indulged in, in all items of expenditure.

The crash, which was bound to come, was hastened by the financial crisis of 1845-46 in Great Britain. It arrested the free flow of capital and supplies to the plantations and also brought about a sharp fall in coffee prices. In 1838-40 the sale price in London was 120s. per cwt. In 1848 it fell to 45s.² Coffee could be purchased in Kandy in 1847 at 12s. per cwt.³ On top of this crash in prices, came two further misfortunes in 1847. A plague of rats gnawed the young coffee shoots, and a wide-spread coffee blight killed the trees. At first a few companies went into liquidation, whereupon nervousness spread like wild fire. Credit could no longer be had and mortgagees began to press for repayment. Plantations which a few years back had been reckoned small fortunes, became almost unsaleable overnight: an estate which had been bought in 1843 for £15,000 could not realize, when put under the hammer in 1847, more than £440.⁴

The crash found the Bank of Ceylon irretrievably involved. It had made heavy advances to planters against properties, which had been rendered almost valueless. Though it was forbidden, by its rules, to advance loans to planters on 'block' debts, in the boom rush, notwithstanding

¹ L. A. Mills, *Ceylon under British Rule*, London, 1933, pp. 236-37.

² Ibid.

³ Andree, p. 83.

⁴ Mills, p. 235.

the presence of a local board of directors, the rule was disregarded by one or more of the managers. In one instance, a loan was made on a defective title deed. The directors at home lacked local knowledge and the local management was wanting in banking experience. When to this situation was added the 'sinister influences in the Colony', imprudent banking was bound to follow. Nearly the whole of the Bank's paid-up capital was locked up and it ultimately lost £60,000. Of this £28,000 represented advances to one individual.

III. *The Oriental Bank Corporation*

Eager to share in the general prosperity, the Western Bank of India, which later changed its name into the Oriental Bank and whose headquarters were in Bombay, had opened a branch in Colombo in October 1843. This bank, however, escaped almost unscathed. Unlike the Bank of Ceylon, which was almost purely a local establishment, it had branches in several countries and commanded vast resources. Its local management had the benefit of a much wider experience, and had exercised due caution in the selection of business. Moreover, in view of the magnitude of its operations, it was in a position to bear such losses as it may have suffered at its Ceylon branches during the crisis.

When the failure of the Bank of Ceylon appeared imminent, the Oriental Bank stepped forward and took over its business and liabilities. In 1851 the two banks were formally amalgamated by a fresh charter under the title of the Oriental Bank Corporation. The terms of the charter were governed by the banking regulations of 1846.

The new bank had a paid-up capital of £1,260,000 and a reserve fund of £252,000. Its activities were restricted to the east of the Cape of Good Hope and it soon developed into a leading bank in the East. It was, however, allowed to keep an agency at Edinburgh, where the 'wealth of the

retired Indian functionaries, Civil and Military, besides merchants (afforded) an important field for banking operations'.¹ Besides in Ceylon and India, it had branches or agencies in Mauritius, Singapore, China, Australia, and New Zealand. Its head-office was in London.² In 1863-64 the bank opened branches in Nuwara Eliya, Badulla and Jaffna.³

An advertisement⁴ of the Corporation, dated 1860, gives its 'principles of business as adapted to Ceylon.' The advertisement is well worth quoting in full as it gives an idea of the nature of the business undertaken by the bank. It runs as follows :—

'The Bank will receive money in deposit at Interest in sums not under £20⁵ in four classes, viz.—

'1.—"Fixed Deposits", bearing Interest to the date of repayment and not withdrawable without thirty days' notice.

'2.—"Fixed Deposits", bearing Interest to the date of repayment and not withdrawable without sixty days' notice.

'3.—"Fixed Deposits", bearing Interest to the date of repayment and not repayable without six months' notice.

'4.—"Current Deposit Account", bearing Interest on all balances exceeding £100, remaining in the Account at the close of each day's transactions, to be operated upon by Cheques at the convenience of the customer.

INVESTMENTS

'The Bank will lend money either in Cash Credit Account or fixed Loans not exceeding 4 months, on the following securities.

'Class 1st.—On Goods not of a perishable nature,

¹ Andree, p. 83.

² *Ferguson's Ceylon Common Place Book*, 1860, p. 167.

³ Andree, p. 84.

⁴ *Ferguson's Common Place Book*, 1860, pp. 167-68.

⁵ A Pound in Ceylon meant Rs. 10. See p. 54 above.

protected by Fire Insurance, on Goods shipped for importation into Ceylon—Adjusted Policies of Insurance of Public Companies—Joint Bonds with two approved securities—And Acceptances and Promissory Notes bearing two approved names, and representing *bona fide* transactions.

DISCOUNT

‘The Bank will discount private Bills and Notes for customers, bearing at least two approved names (unconnected with each other in general partnership), and not having more than four months to run.

AGENCY

‘The Bank will act as Agents for the purchase and sale of Investments in the Loans of the Indian Government, and other Public Securities in India and elsewhere; and will collect and remit halfpay for constituents free of charge.

RATES OF INTEREST, DISCOUNT, COMMISSION

Interest allowed by the Bank

- ‘1st.—On fixed deposits at 30 days’ notice . . . 3 per cent.
- ‘2nd.—On fixed deposit at 60 days’ notice . . . 4 per cent.
- ‘3rd.—On fixed deposit at 6 months’ notice . . 6 per cent.
- ‘4th.—On current deposit accounts to be operated
at pleasure, on all balances of £100 and
upwards 2 per cent.

EXCHANGE

‘The Bank’s rate for purchase and sale of Bills on England and the different Presidencies¹ (of India) are

¹ It also bought and sold bills on China, Singapore, Mauritius, Australia, and New Zealand, in which countries it had branches, agencies or correspondents. See *Ferguson’s Common Place Book*, 1860, p. 163.

constantly, exhibited in the Public Office, and are inserted once every week in each of the public Journals.

‘On purchase or sale of investments in Public Securities and on other special acts of Agency $\frac{1}{2}$ per cent.

‘Office hours 10 to 3-30. Saturdays 10 to 2.’

Thus the Corporation was a bank of deposit and exchange, which utilized its capital and deposits, chiefly in the finance of foreign trade and partly in providing the short-term capital requirements of business and the plantations. The advertisement shows how little the nature of the business of the exchange banks has changed during the three-quarters of a century which has elapsed since then.

IV. *The Exchange Banks*

The depression in coffee, which had begun in 1847, lasted for about three years. Recovery, when it began, was slow. By 1853, however, revival was complete and the industry, which was the chief source of the Island's wealth, had entered upon a fresh period of increasing prosperity. Early in the following year, to partake of the return of prosperity, the Mercantile Bank of India, London and China, which had its headquarters in London, opened branches in Colombo and Kandy. Later it established an agency at Galle. The Mercantile Bank obtained a charter in 1858, whereupon it prefixed the word ‘Chartered’ to its title. Its capital was £500,000 which it was free to raise to £1,500,000.

The line of business of the Chartered Mercantile Bank generally agreed with that of the Oriental Bank Corporation. Referring to the functions of the two banks, H. D. Andree, Accountant of the Chartered Mercantile Bank, wrote as follows in 1864 :—

‘The two Banks established in Ceylon are strictly and avowedly *Banks of Exchange*, that is to say, the distinguishing principle of their business is to deal in Foreign Bills

of Exchange, the other branches of Banking being considered merely accessory. Thus the entire capital of the Banks may be said to be devoted to exchange business, being constantly employed in going backwards and forwards between the different branches and their head-office etc., while a portion of their deposits and circulation (i.e. notes) is lent out to customers upon promissory notes and the balance held as reserve.'

The initial reception which the new bank got at the hands of the older institution was none too cordial. The Corporation had enjoyed monopolistic privileges since the failure of the Bank of Ceylon in 1847. The only rivals it had to reckon with were the Chettiar bankers, whose activities, however, were more complementary to those of the Corporation and less competitive. It was, therefore, not without some feeling of irritation that it viewed the coming of a new bank in the Island, which it had come to regard as its well-established preserve. Hostility soon led to rate cutting. The commission on remittances to Kandy, for which, hitherto, the planting community had paid one per cent, fell to one half per cent, and 'Exchange on London forced up at one time to the unnatural pitch of a premium'.¹ But Colombo was too limited a field for the display of such suicidal antagonism. Both parties, therefore, took an early opportunity to arrive at a better understanding. Thereafter they worked by mutual agreement in regard to exchange, discount and interest.

The Oriental Bank Corporation and the Chartered Mercantile Bank remained the chief banks in the Island until the Bank of Madras came on the scene in 1867. The efforts made in the intervening period by several Indian as well as foreign banks to establish themselves in the Island were unsuccessful. None of the branches, which were

¹ Andree, p. 84.

opened from time to time, remained in the Island for long.¹ In January 1881, the National Bank of India, which had been working in India since 1863, opened a branch in Colombo.

Reference has been made elsewhere to the failure of the Oriental Bank Corporation. It closed its doors on May 3, 1884. This was one of the biggest financial crashes in the history of European banks in the East. The Corporation's paid-up capital was £1,500,000 and it had built up a reserve fund of an equal amount. Hardly any evidence, however, is available locally of the causes of the Corporation's failure. Banking statistics are not on record. But the bank was believed, for some time, to have been 'notoriously engaged in large transactions, many of which were known to have been of a speculative character'.² The crash, therefore, could not have been altogether a surprise. The Island was then under the shadow of the wide-spread destruction worked out by the coffee blight, which had appeared for a second time, and tea and cinchona had only partially replaced the devastated coffee plantations. The community, however, was saved from complete paralysis, as we have seen, by the prompt guarantee of the bank's notes by the Government.

The bankrupt Corporation was followed by another bank with a similar name (the New Oriental Bank Corporation) in 1885 with a capital of £583,470.³ But it met with the fate of its predecessor in 1892 and was not reorganized

¹ In 1865 a branch of the Asiatic Bank commenced operations in the Island but was closed down in October of the following year. The Bank of Hindustan opened a branch in July 1864 which was wound up in November 1866. The Royal Bank of India commenced business in Colombo, in March 1865, but left the Island in December 1866. The Comptoir D'Escompte de Paris came in 1877 but left two years later. See *Ferguson's Ceylon Directory*, 1932, pp. 702-03.

² *Sessional Paper I of 1886*, p. 19.

³ Advertisement of the bank in *Ferguson's Ceylon Directory*, 1890-91, p. xiii.

again. In 1892 two new banks, the Chartered Bank of India, China and Australia, and the Hongkong and Shanghai Banking Corporation, commenced business in the Island. In the following year, the Chartered Mercantile Bank of India, London and China, was voluntarily wound up and reconstructed. It assumed the simpler name of the Mercantile Bank of India and began operations on January 1, 1893. In 1921 the Imperial Bank of India was formed by the amalgamation of the three Presidency Banks, including the Bank of Madras.

After the Great War I, several Indian banks and two exchange banks opened branches in Ceylon. The Eastern Bank, founded in 1919, came to the Island in 1921, and the P. & O. Banking Corporation in 1922. The latter was absorbed by the Chartered Bank of India on January 31, 1939. The Indian banks which opened branches in the Island were, the Indian Bank (1932),¹ the Travancore National and Quilon Bank (1936), the Oriental Bank (1937), the Nadar Bank (1937), and the City Bank (1934). Among them the Travancore National and Quilon Bank, which was the largest, failed in 1938 and is, at present, in the hands of liquidators, the Nadar Bank voluntarily wound up its business in Ceylon in May 1939, and the City Bank closed down in June 1939.

It is noticeable that, unlike in India, where there are several non-British exchange banks, the exchange banks in Ceylon are wholly British. This is, probably, due to the Island's trade with countries other than Great Britain being not sufficiently large to induce non-British exchange banks to set up business in the Island. Excepting two, which have a great part of their business in the Far East, the exchange banks, belong to that group, which do a considerable proportion of their total business in India. It

¹ Figures within brackets are the dates when the banks arrived in the Island.

is also noticeable that none of the joint stock banks named above are Ceylonese. The Island's banking and finance are almost wholly in foreign hands, chiefly British and partly Indian. The bulk of it is controlled by five exchange banks and the Imperial Bank of India. The only national bank in the Island is the Bank of Ceylon founded in 1939.

The first purely indigenous banking effort was not made until 1917, when there was started the Bank of Colombo. But it did not produce any very brilliant results. Its promoters as well as the management do not seem to have had any considerable banking knowledge or experience. The prospectus of the bank assured the prospective shareholders that they could take back, when required, a part at least of their capital subscription in the form of loans on the security of the shares. It will be recalled that the Colonial banking regulations had forbidden this practice, as it amounted to a reduction of the share capital, as early as 1840. The promise made in the prospectus was liberally fulfilled, and a good part of the shares returned to the bank as collateral or as original security for advances. Also, four-fifths of the capital and 50 per cent of the deposits were loaned out to directors on the security of the bank's shares or against immovable properties. It is not surprising, therefore, that public confidence in the bank, which was never too great, soon disappeared, and it closed its doors in 1921.¹ The paid-up capital of the bank was Rs. 500,000 and the reserve fund, built up in the course of four years, was Rs. 5000.

Banking and finance in Ceylon are centred in Colombo, the chief town of the Island and the centre of the mercantile community. All the banks in the Island have their principal branches in the town. The Chartered Bank, the Hongkong and Shanghai Banking Corporation, the Eastern Bank, and the Imperial Bank of India, have no branches outside

¹ *Sessional Paper XXII of 1934*, p. 25.

Colombo. Among the rest, the National Bank of India has branches in Kandy and Nuwara Eliya, the Mercantile Bank of India in Kandy, Galle and Jaffna, and the Indian Bank in Jaffna. As already noted, the exchange banks do not distinguish between their business in Ceylon and abroad in their published accounts. It is not possible, therefore, to attempt any complete account of their activities in the Island. Much of their business, however, is very like that of any other bank.

In addition to their capital and the reserves accumulated from profits, the exchange banks obtain their funds by receiving deposits on current account, for fixed periods, and one of them, on savings accounts also. Before the Great War I these deposits were received in London as well as in India and Ceylon, but their principal object was to obtain as much as they could in London, and they sought to attract such deposits by offering better terms than an English bank would allow.¹ On fixed deposits, received for a year or more, as much as 4 or $3\frac{1}{2}$ per cent was paid; for shorter periods a more variable rate was offered; and on current accounts 2 per cent was allowed, on the minimum monthly balances or on the amount by which the balance exceeded a certain fixed minimum.²

These rates are now a thing of the past. After the depression, with the tendency to restrict operations, the interest offered is on a much lower scale and the banks depend largely upon local deposits. Fixed deposits for a year or longer, fetch no more than $1\frac{1}{2}$ per cent, deposits for shorter periods $\frac{1}{2}$ to 1 per cent, and current accounts either yield no interest at all or a mere $\frac{1}{2}$ per cent on amounts in excess of a minimum which, in the case of some banks is Rs. 1000, and, in the case of others, Rs. 2000. Only one exchange bank accepts savings deposits. It

¹ J. M. Keynes, *Indian Currency and Finance*, London, 1924, p. 209.

² *Ibid.*

allows an interest of $2\frac{1}{2}$ per cent on them, which compares with 2.4 per cent offered by the Post Office Savings Bank, and $3-3\frac{1}{2}$ per cent by the Ceylon Savings Bank.¹ In the matter of interest allowed on deposits, the rate for the collection of bills and such other matters, the banks work on an agreement through the Colombo Exchange Banks' Association. Since the first exhibition of the mutually destructive rate cutting rivalry in the 'fifties of the last century between the two pioneer exchange banks in the Island, they have not repeated the experiment and have practically always pursued an agreed policy of credit and discount. Probably, the measure of agreement among them in Ceylon is closer than exists, or is possible, in India. For, the number of banks here is few, their chief offices are within a few yards of one another, and all of them belong to one nationality:

Apart from the cash reserve, money at call, and investments in high class securities, which every bank must hold, their funds are employed in making loans in the shape of advances and overdrafts, and in the purchase or discount of bills of exchange. With the increasing tendency to depend upon local deposits, the local business of the banks, i.e. the business of advances, overdrafts, buying and selling of securities for constituents etc., has tended to increase also. In part this would seem to follow from the natural desire of the banks to invest their deposits, as far as possible, in the centre where the deposits are payable.

In the past, when they attracted large amounts of deposits through their head-offices in London, they could not safely invest too large a proportion of them in local business, apart from foreign bills of exchange. The latter, as they were payable in London, were, in fact, British assets, though purchased or discounted in Ceylon, and, therefore,

¹ *Sessional Paper XXII of 1934*, para. 104.

fitted in with their desire to keep sufficient British assets against their British deposit liabilities. But under the altered circumstances in which the banks obtained deposits locally, they could conveniently pay greater attention to the credit wants of their local constituents and Ceylonese business and industry generally. The banks, therefore, advanced loans to the Chettiars and others more liberally than in the past.

The Ceylon Banking Commission estimated, from private enquiries, that, the banks' loans to the Chettiars sometimes amounted to as much as Rs. 25 millions.¹ They were mostly made at the 'Chetty rate' of interest or the rate at which the Imperial Bank of India lent to the Chettiars, namely, 2 to 3 per cent above the bank's official rate of discount for first class *hundis*. The security was mostly personal security of the two parties to the promissory notes, which the banks discounted. Sometimes, more commonly in the case of non-Chettiars, fixed property was taken as collateral security. The depression in which the Island, along with the other primary producing countries, suffered more than the rest of the world, however, led to a change of policy. In the 'Chetty Crisis', which came on the heels of the depression, the banks lost heavily and in self-protection they drastically cut down the volume of Chetty loans as well as collateral loans on fixed property. In 1934, according to the estimate of the Nattukottai Chettiars' Association, the banks' loans to the Chettiars did not exceed Rs. 1 million.² It is, probably, not any higher today, if not appreciably less.

All the time, however, foreign exchange transactions have remained the largest single item of the banks' business. If local business has grown with increased local deposits, so has the volume of the foreign bills of exchange. The

¹ *Sessional Paper XXII of 1934*, para. 169.

² *Ibid.*, para. 103.

following figures may amuse the curious. Andree estimated the deposits of the Island in 1864 to be nearly Rs. 10,000,000. The figure comprised 'the Floating and permanent balances of Customers in all the Banks, the Savings Bank included.'¹ In 1933, the deposits of the exchange banks and the Imperial Bank of India (excluding Government deposits) were Rs. 122 millions, or a rise of somewhat above 12 times since 1864. Exchange business, probably, increased in nearly the same proportion between the two dates. For, the Island's foreign trade rose from Rs. 31.1 millions in 1864 to Rs. 360.6 millions in 1933, or an increase of slightly under 12 times.

V. *The Imperial Bank of India*

The Imperial Bank of India is in a class by itself. Unlike the other Indian joint stock banks, which were incorporated under the general Companies Act, it was established by special law, the Imperial Bank of India Act, 1920. In view of its special responsibilities as banker to the Government of India, at that time, the bank was prohibited by the Act from transacting certain forms of business such as dealing in foreign exchange, lending against the primary security of immovable property, granting loans for periods longer than 6 months, making advances against personal security, except on the several responsibility of at least two persons or firms unconnected with each other in general partnership, etc. Some of these restrictions on the business of the bank were removed by the Imperial Bank of India (Amendment) Act, 1934, as, by the Reserve Bank of India Act of the same year, the banking business of the Government was proposed to be taken over by the Reserve Bank when it commenced operations.

¹ Andree, p. 97.

An important change introduced by the amending Act, which came into force on April 1, 1935 simultaneously with the inauguration of the Reserve Bank, is that the bank is now authorized to buy bills of exchange payable out of India, to borrow money out of India, and to transact foreign exchange business. The old restrictions such as the restriction on loans upon the primary security of fixed property, etc., however, still continue to operate. For, by an agreement with the Reserve Bank, the Imperial Bank of India retains a portion of its official functions, as the sole agent of the Reserve Bank for the transaction of Government business in all places where there are branches of the Imperial Bank but where there are no branches of the banking department of the Reserve Bank.

The Colombo branch of the bank had thus to restrict its business to deposits, discount of bills arising out of the trade with India, and short-term advances not exceeding six months. But this did not in any way interfere with the usefulness of the bank to the Island. Whenever financially sound parties had approached the bank, it had advanced demand loans on joint signatures, and, in practice, the loans were allowed to run for six months. Property was taken as collateral security further to secure the advances, after they became difficult of recovery. In this manner it had made large advances to the tea, rubber, and coconut industries, in the development of which, during more than seventy years of its career and that of its predecessor, the Bank of Madras, in the Island, it has played no small part. Until the 'Chetty crisis' of 1929, the bank was a principal lender to the Chettiars. Indirectly, therefore, through the latter, it was an important source of funds for mortgage loans in the Island.¹

Before the commencement of the Reserve Bank of India,

¹ *Sessional Paper XXII of 1934*, para. 122.

the Imperial Bank had been discharging some of the duties of a central bank in India by virtue of the importance of its position. This part the bank continues to play in Ceylon today.

The exchange banks, as in India, practically at all times, purchase or discount far more export bills than they can afford to hold until maturity. As the vast majority of the bills are bought by the banks *in Ceylon*, while cash is received for them, either at maturity or through rediscount, *in London*, they are constantly in the position of finding themselves in funds in London and of wishing to have funds, for the purchase of more bills in Ceylon. A portion of them, they bring back through the sale of sterling drafts or telegraphic transfers to importers of European goods into Ceylon, to the Government to meet the latter's sterling obligations, to European residents who wish to make remittances home, and by securing from the London market bills drawn on Ceylon. But, as exports to European countries greatly exceed in value imports from them into Ceylon, considerable portions of the funds still remain behind in London.

The method of shifting the funds to the Island, which the currency law provides, is to procure rupee coins by disposing of sterling in India, or offering it to the Indian currency authority at its buying price, importing rupees so obtained into Ceylon, presenting them to the Commissioners of Currency, and getting in exchange Ceylon currency notes. But this is a very circuitous as well as expensive method, worth while only as a last resort. It involves the delay and expense of importing rupees from India and, if sterling cannot be sold in the market but has to be offered to the Indian currency authority, the additional cost resulting from the fact that the statutory buying price of the latter (18 $\frac{3}{4}$ d. per rupee) is very unfavourable.

Recourse to this final device is rarely, if ever, made by the exchange banks, as they find in the Imperial Bank of India a quicker, and more satisfactory, solution to their problems. The Imperial Bank receives moneys in Colombo in exchange for drafts on its Indian branches, which represent payment for goods imported from thence, or savings and family allowances sent home by Indian residents in Ceylon. It has also at its disposal, funds received in liquidation of trade bills sent here for collection from its Indian branches. These are, in effect, funds belonging to its Indian branches temporarily transferred to Colombo and which, the bank is anxious to send back to India. In other words, it is in the position of having funds in Ceylon and wanting funds in India.

If, therefore, the exchange banks could convert sterling credits in London, into rupee credits in India, the Imperial Bank would readily come to their assistance by surrendering cash in Colombo in exchange for funds in India. Such conversion would at once enable the exchange banks to even up their accounts as between London and Ceylon. This they proceed to do through one of their Indian branches. Sterling can always be sold in India, to the Reserve Bank of India (formerly to the Controller of Currency) at the tender made on behalf of the Government of India, practically every week, to meet Home Charges, or at $\frac{1}{2}$ d. above the latest tender rate on tap, or at its statutory buying price. The Ceylon banks, therefore, transfer their sterling purchases to their Indian branches through their London office and sell to the Imperial Bank drafts on the former against the proceeds of the sale of sterling. The Imperial Bank surrenders funds in Colombo in exchange for the drafts and charges the banks a small commission, often as low as $\frac{3}{4}$ per cent and based upon the cost to the Imperial Bank of replenishing and maintaining a cash balance sufficient to meet all normal requirements

of the exchange banks. When this had to be done by importing rupee coins the commission charged was governed by the cost of importing the coins and was usually $\frac{5}{32}$ per cent. But, after the Currency Commissioners began issuing notes against sterling or rupee credits, the commission was lowered, on a representation being made on the subject by the exchange banks to the Imperial Bank. The latter, however, is free to raise the levy to the old level by giving a week's notice to the exchange banks, in the event of the Commissioners declining to issue notes against exchange and insisting upon having silver rupees instead.

In order to save this commission for themselves, the banks sometimes offer to their constituents, as well as other applicants, drafts on their Indian branches at par. They also endeavour to secure, in competition with the Imperial Bank of India, as much of the bills arising out of the Indian imports into the Island as conveniently possible. These, while helping to solve their exchange problem, bring them also profits in the shape of discount or commission for collecting the bills. But, in view of the vast branch and agency connection of the Imperial Bank in India (over 350) the bulk of the Indian business is controlled by the bank and the exchange banks have perforce to do the greater portion of their exchange clearing through it.

The method of telegraphic transfers enables the parties to act with great despatch during busy periods. The Ceylon branches of the exchange banks then obtain immediately the funds from the Imperial Bank, enabling them to take the trade bills, the offer of which had seemed to them to be at sufficiently attractive rates to make the transaction taken as a whole worth while. A few weeks later (since the coming of the 'all-up' mail, only a week

later)¹, the bills reach London, are duly accepted, and are capable of being rediscounted, if additional free funds are needed for a repetition of the transaction and quick turn-over.

We are now in a position to understand the importance of the Imperial Bank in the Island's banking system. In the absence of the facilities afforded by it, the exchange banks would be forced to put themselves in funds in Ceylon by importing rupees. This causes delay or additional expense in the discounting of bills in Ceylon. In other words, Ceylon traders are less easily able to turn the merchandise they are shipping into money.

It is also easy to see why the banking system generally acts through the Imperial Bank of India whenever the market needs excess currency or wishes to return to the Currency Commissioners any excess supply of it and wants in exchange specie or other means for covering an adverse foreign balance. The remaining banks do not approach the monetary authority except when they require small quantities of silver for purposes of internal circulation or wish to convert similar amounts, brought to them by the public, into notes. When the exchange banks' drafts on their branches in India (which, it will be remembered, represent the foreign credits of the Island acquired through exports to Europe and elsewhere) sold by them to the Imperial Bank are insufficient to absorb the funds belonging to the Indian branches of the bank collected at its Colombo office, the latter has to find other ways of transferring the balance to India.

The unabsorbed 'Indian' funds tend to be vast when the normally favourable trade balance diminishes or turns passive: they are a sort of financial barometer indicating the state of the current indebtedness of the Island. The

¹ This refers to the pre-war position.

size of these funds are a measure of the shortage of the available foreign exchange to liquidate the current debts due abroad. And, through leaving a portion of the 'Indian' funds on the hands of the Imperial Bank, the banking system places the burden of procuring such exchange to make good the deficit, on the shoulders of the bank. This the latter does by offering equivalent notes to the Commissioners of Currency for conversion. The rupee coins, or foreign exchange, obtained from the Commissioners, the Imperial Bank remits to India, which squares up the position.¹

Conversely, when the Imperial Bank's 'Indian' moneys are all sold out, and the exchange banks continue to offer drafts on their Indian branches to it or have excess sterling in their possession, it means that the Island's foreign credits exceed its foreign debits. The only way now open to the banking system to place itself in funds in Ceylon is to import rupee coins from India and offer them to the Commissioners for currency notes. But, as the Imperial Bank of India is in a better position to import rupees from India than the exchange banks the latter find it convenient to get this done through the Imperial Bank.² The exchange

¹ In view of this analysis the following remarks in the *Report of the Colonial Auditor for 1927-28* (p. 113) seem significant: 'The fall in the above proportion (of the coin reserve) is partly due to the withdrawal from circulation of notes to the value of Rs. 5 millions presented by a bank (i.e. the Imperial Bank) *which had to transfer its accumulated balances to India.* (Italics are mine.) One half of this amount was paid in rupees from the coin reserve and the other half was paid by the sale of investments held in India on behalf of the Currency Commissioners.'

² Due to the obvious advantages of this system to both parties, the Imperial Bank and the exchange banks have come to an agreement with regard to dealings in Indian exchange. Under the terms of the agreement the exchange banks undertake not to import rupee coins from India nor sell Indian exchange to each other. They may sell Indian exchange only to the Imperial Bank of India or to the public. In return the Imperial Bank agrees to provide the exchange banks with cash in Colombo against credits in India (or London) at a reasonable commission.

banks sell their foreign credits to the Imperial Bank at a discount not higher than the cost of importing rupees. And once again the Imperial Bank evens up the Island's foreign balance accounts, either by importing rupees or otherwise acquiring currency from the Commissioners by offering to them sterling exchange.

Under these circumstances it seems natural that the Imperial Bank should have come to act as the settling bank. The exchange banks find it necessary to keep accounts with it in connection with the finance of their exchange operations and by general agreement, therefore, it is convenient for them to do their clearing through it. The Colombo Bankers' Clearing House, which was established in 1885, was at first located in the premises of the Bank of Madras and later was taken over by the Imperial Bank of India, the successor of the Bank of Madras.

The strength of the bank's position, which it inherited from the Chettiar bankers of the pre-commercial bank period, through the Oriental Bank Corporation and the Bank of Madras, rests chiefly upon, it will be noted, two factors: (1) the habitual surplus exports of the Island to European countries and the equally habitual surplus imports from India; (2) the currency law under which Ceylon currency cannot be demanded from the Currency Commissioners otherwise than by offering Indian rupee coins. The first of these two factors places the exchange banks with surplus funds in London and the Imperial Bank with surplus fund in Ceylon, and the second, by making it expensive to transfer funds to Ceylon through importing rupees from India, forces the exchange banks 'into' the Imperial Bank of India for the final solution of their transfer problem. It seems inevitable, therefore, that in a situation such as this the bank which controls the finance of Indian trade must hold the key position.

The coming of the Indian joint stock banks into the

Island after the Great War I has not diminished the importance, or reduced the business, of the older institutions. Their coming and going is becoming a regular feature like the coming and going of some of the exchange banks sometime during the latter part of the 19th century. If we exclude the Bank of Chettinad, which is a private firm and accepts no deposits from the public, and the Oriental Bank, which is a small concern with a capital and reserve under Rs. 16,000, at present there is only one Indian joint stock bank in the Island, namely, the Indian Bank. It has a capital and reserve of about Rs. 27 lacs, which, however, is less than $2\frac{1}{2}$ per cent of the capital and reserve of the Imperial Bank.

VI. *Chettiar Banking*

The place of the Chettiar bankers in the Island's finance is vastly more important. Their connection with the Island dates back to the Dutch period or, probably, even earlier. But under a regime of State monopoly in nearly all lucrative trades, which obtained under the Dutch, they did not find much scope for their activities. With the restoration of the freedom of individual enterprise and the opening up of the country under the British, however, increased opportunities arose for the employment of their funds. And for a time they were the chief source of finance in the Island. We have seen how the early British trading houses depended upon them for credit in times of emergency. But, after the coming of the European banks, whose arrival they must have hastened through their inability or unwillingness to adjust their business to altering conditions and their incapacity to discount sterling trade bills, their importance declined.

The arrival of the Bank of Madras, which soon assumed control over the finance of Indian trade, still further reduced their importance. They had thereafter to be content with

the position of intermediaries between the banks and the indigenous demand for credit. They became a safe outlet for the excess funds of the banks, chiefly the Bank of Madras, and later the Imperial Bank of India. These, with their own capital, they invested in mortgage, and other, advances to the Ceylonese agriculturists and traders.

Notwithstanding this diminution in the sphere of their activities, the Chettiar bankers still hold an important position as a source of credit in the Island. Being deprived of the business of greater liquidity, security, and certainty, they directed their capital into channels which, though vastly more risky, promised greater returns. They became the chief purveyors of mortgage credit in the Island, more especially to the Ceylonese for whom, with the exception of a few who may obtain accommodation from the banks, Chettiar bankers have always been almost the only source of credit, short as well as long. In this field they had to contend with no rival until 1932, in which year the State Mortgage Bank commenced operations. But when compared to the size of their business (Rs. 150 millions before the depression)¹ the total loans of the Mortgage Bank during the first five years of its career (Rs. 3.7 millions),² seem insignificant.

The Memorandum submitted by the Chettiars' Association to the Banking Commission estimated that the investments (in 1934) of about 450 principal Chettiar firms in the Island were about Rs. 100 millions. Of this amount, 85 millions represented their total capital, 14 millions were raised in India from relations and friends, and 1 million was borrowed from the local banks. The investments were distributed as follows: Rs. 30 millions in land and estates, Rs. 49 millions in running mortgages, advances on promissory notes, etc., and Rs. 16 millions chiefly in rice and

¹ The Banking Commission, 1934, thought this figure to be an underestimate.

² *Sessional Paper XXIV of 1936*, pp. 5-6.

other trades and partly in house property.¹ Rs. 5 millions were held on deposit with the banks. The locking up of their funds in land and estates was quite contrary to their intentions and was mostly the result of foreclosure of mortgages. Before the depression their investments in the Island were much larger. The Memorandum estimates it to have been about Rs. 150 millions. But considering that Chettiers were the principal lenders to the indigenous population and also the vast indebtedness of the community, the Commission was inclined to believe that there was a considerable disparity between these figures and the actual Chettiar interests in the Island.²

The Chetty crisis of 1929 illustrated the danger of mixing up short-term liabilities with long-term investment financing,

¹ The Chettiers' Memorandum classifies the investments as follows (*Sessional Paper XXII of 1934*, para. 167.):—

	Rs.	Rs.
'A' IN BUSINESS AND PROPERTIES—		
(1) About 50,000 acres of agricultural land and estates (approximate distribution in various kinds of estates and lands being 70 per cent coconut, 15 per cent rubber, and 15 per cent tea, cocoa, etc.)	(1,000)	(1,000)
(2) In purchasing house properties in principal towns	30,000	
(3) As business capital in retail shops, estate supplies, rice-trade, import business, etc.	6,000	
	10,000	
		46,000
'B' IN LENDINGS—		
(4) In pawn-broking advances	4,000	
(5) In mortgages	20,000	
(6) In other advances, i.e., on promissory notes, etc.	25,000	
(7) In deposit with banks	5,000	
		54,000
Total	...	100,000

² *Sessional Paper XXII of 1934*, para. 170.

and to the banks it revealed the risks of advancing unsecured loans to firms engaged in such business. It seems surprising, however, that the system, which appears to be fundamentally defective, should have worked, apparently, with such remarkable success for so long a period. The promptness with which the Chettiars repaid the advances made to them, increased the confidence of the banks in them to such a degree that the banks did not hesitate to accommodate them freely after going through the necessary technical formalities. In the absence of a discount market and its usual adjunct a market for call-loans, the Chettiars' promissory notes proved to the banks a useful and dependable instrument in which to invest their deposits, and, in view of the considerable margin of difference, between the rates they charged and the rates they had to pay, the loans were welcome to the Chettiars as well.

The success of the system rested upon two main factors : partly, the unwillingness of the Chettiars generally to borrow beyond capacity, but chiefly, the traditional practice prevailing among them of inter-Chetty lending. The greatest part of the mortgage and other investments of the Chettiars represented their own capital and they never allowed their borrowings from the banks to exceed a certain proportion of their own assets. In the figures submitted by the Chettiars' Association to the Banking Commission, the loans from the banks to the Chettiar firms (before the crisis) was under 17 per cent¹ of their total investments. A Chettiar valued his reputation among his brother Chettiars very dearly. And they looked upon too frequent, or too large, loans from the banks on the part of any among them with disfavour.

But the system of inter-Chetty lending was the chief support of the successful working of Chettiar banking.

¹ This compares with an annual income (gross) of over 13 per cent on their investments.

When in need of liquid funds they freely lent among themselves, at the usual inter-Chetty rate (6 per cent or under) or the rate charged by the bank, whichever was higher, if, in order to accommodate a brother in the trade, a Chettiar had to borrow from a bank. Thus so long as some among the Chettiars had untapped margins of credit at the banks, none of them, whose position was otherwise sound and could prove it to be such to his prospective Chetty creditor, had to fear, in all normal times, inability to meet his short-term obligation to his bank. Thus, the Chettiars, through the age-old practice of being their own mutual lenders of last resort, were able to use loans from the banks, sometimes from the same bank, to meet the maturing bank loans. To the extent this happened, it was the bank's own money which enabled the Chettiars to keep their loan contracts with the banks, with striking promptness.

So long as the price of coconut and rubber remained above production costs, payment of interest, and repayment of capital, were regular, the value of mortgages remained high, and, taking the Chettiar bankers as a body, whilst the proportion of their bad debts or foreclosures of mortgages were not considerable, the weaknesses of the system never appeared on the surface. But the crisis of 1929 was general as well as intense. Its effects being widespread the Chettiars were unable to obtain assistance from their branches in India, Burma, Malay States, Straits Settlements, or Siam. The banks which had, hitherto, freely come to their assistance, alarmed at the failure of one or two Chettiars to meet their contracts, began calling in loans and stopped all further Chettiar advances. The long-term assets of the Chettiars being nearly useless immediately to meet their short-term pro-notes, the system collapsed. And from the effects of the shocks which Chettiar banking received in the crisis, it has not as yet shown any great signs of recovery.

CHAPTER VII

THE BANK OF CEYLON

I. *The Pochkhanawala Banking Commission, 1934*

THE difficulty experienced by the Ceylonese generally in raising sufficient credit on reasonable terms became acute during the last depression. Though money was plentiful the terms on which advances were made grew more and more rigid. The banks stopped their loans to the Chettiar bankers on the old easy conditions and the latter were not too keen to raise money on any other terms. Owing to the effects of the depression they were unwilling to accommodate borrowers as liberally as before and needed no assistance from the banks. An important source of the supply of funds to the indigenous part of the money market was thus cut off. The Chettiars, in rearranging their accounts to suit the new situation, called in some of their loans and then settled down to a more restricted credit policy. Many abandoned money lending altogether and, probably, nearly all began to pay greater attention to trade, industry, and estate ownership, which seemed to offer better scope for their talents and better security for their capital. Thereupon some of the prospective Ceylonese borrowers approached the banks only to find that their claims for loans were subjected to very much greater scrutiny than was done by the Chettiars.

This led to a feeling of discontent against the existing credit system, and provoked a demand for a general banking inquiry. A motion was accordingly brought before the State Council on the subject in November 1932, which ultimately led to the appointment of a Banking Commission

in April 1934, with the late Sir Sorabji Pochkhanawala (then Mr. Pochkhanawala), Managing Director of the Central Bank of India, as Chairman, and the late Sir Hilarian M. Fernando and Dr. S. C. Paul, as members. The terms of reference of the Commission were, 'to enquire into and report upon the existing conditions of banking and credit in Ceylon and to consider the steps, if any, that are feasible and desirable in respect of the provision of banking and credit facilities for (a) agriculture, (b) industry, (c) trade, and also to make recommendations regarding the desirability of a State-aided Bank and sound local banks.'

II. *The Commission's Scheme for a State-aided Bank*

The Commission submitted its report¹ in November 1934 and made the establishment of a State-aided national bank the central feature of its recommendations. We shall briefly review the draft scheme proposed by the Commission. The authorized capital of the bank was put at Rs. 20 millions of which half, comprising 80,000 (convertible) cumulative preference shares of Rs. 100 each bearing interest at 3 per cent, and 80,000 ordinary shares of Rs. 25 each, were to be issued in the first instance. The former were to be taken over by the State and the latter were to be offered for public subscription. To begin with the State was to pay half the value of its shares and the public were to be offered half the ordinary shares on which Rs. 15 per share was to be paid up at once, the balance being left to be called in instalments of Rs. 5 after intervals of not less than six months. The opening paid-up capital of the bank was thus to be Rs. 4,600,000 of which Rs. 600,000 would be contributed by the public and the rest by the Government.

¹ *Sessional Paper XXII of 1934.*

Some of the functions of the bank as outlined in the report were as follows:—

1. To open current, fixed, and savings accounts.
2. To buy and to sell Ceylon Government and foreign Government securities and bullion.
3. To under-write, subscribe to, and invest in, shares of joint stock banks and other companies registered in Ceylon.
4. To deal in local and foreign currencies, but not within two years of its registration and thereafter only with the approval of the Governor.
5. To do agency work.
6. To lend money on:—
 - (a) Immovable properties up to a maximum of 25 per cent of the paid-up capital and reserve of the bank, subject to the condition that the amount advanced did not exceed 50 per cent of the estimated value of the property in each case and the yield from it did not fall short of an amount sufficient to provide $1\frac{1}{2}$ times the interest on the loan.
 - (b) Agricultural produce and manufactured goods.
 - (c) Bills of lading and documents of title.
 - (d) Promissory notes and bills of exchange bearing two independent names unconnected with each other by partnership.
 - (e) Ceylon Government and foreign Government securities.
 - (f) Debentures and fully paid shares of joint stock companies registered in Ceylon and elsewhere.
7. To discount local or foreign bills.
8. To do safe custody work.

These functions make a unique and perilous combination of industrial and agricultural investment financing with deposit banking business. In important particulars they

go further afield than the German 'mixed' banks on which the bank is believed to have been modelled. Though the German banks did undertake issuing and under-writing of shares and stocks, it was not part of their policy to participate more or less permanently in industrial undertakings, in which they were interested. Shares which they took over in the first instance they passed on to the investing public. In effect, therefore, they were merely intermediaries between the promoters of enterprises and the investors. Their action amounted to little more than guaranteeing the success of the issue. Only, they implemented the guarantee, before the issue to the public actually took place. As they always proceeded with mature deliberation, it was rarely that any part of the issues remained on their hands. The balance sheet of a German bank did not contain any considerably larger proportion of securities in its assets than that of an English bank.¹

The State-aided Bank of the Commission was expected to aim further than this. It was required to assume a more active role in bringing about the industrial and economic regeneration of the Island. It may hold up to 50 per cent of the subscribed capital of a bank about to be floated, and up to 25 per cent of a commercial or industrial undertaking.²

Perhaps the bank bears closer resemblance to the *Credit Mobilier* founded in France in 1852. Like the *Credit Mobilier*, the State-aided Bank was required to promote banking, industrial, and business undertakings in the Island. It should subscribe to their initial capital, hold their shares until they reach sufficient profitability to attract private investors, thereupon dispose of them to the public, and turn its capital over again in another transaction of the same

¹ P. Barrett Whale, 'English and Continental Banking', *Journal of the Institute of Bankers*, June 1931.

² *Sessional Paper XXII of 1934*, para. 351.

kind. But the *Credit Mobilier* did not depend for its resources on short-term deposits of the public. It raised them by the issue of debentures.

It also combined in it elements of the *Credit Foncier*. For, the bank was required to provide long-term mortgage credit on the security of urban, as well as agricultural, property. To the functions appropriate to these two institutions were added commercial banking business, certain central banking functions such as acting as bankers to the Government and making ways and means advances to the Treasury, and the business of financing colonization schemes, the co-operative movement, etc.

On March 14, 1935 the State Council carried a motion moved by the Hon'ble Mr. G. C. S. Corea, Minister for Labour, Industry and Commerce, recommending the 'immediate establishment under the provisions of "The Joint Stock Banking Ordinance, 1897", of a State-aided Bank in Ceylon generally on the lines indicated' by the report of the Banking Commission. Thereupon, a sub-committee appointed by the Board of Ministers comprising the mover of the resolution and the Hon'ble Mr. H. J. Huxham, Financial Secretary, drafted the Memorandum and Articles of Association of the proposed bank, practically on identical terms with the Commission's recommendations.¹ These were forwarded by the Governor to the Secretary of State in May 1935 for his consideration.²

¹ One or two amendments, which were introduced, related to points of detail. The preference shares to be taken by the Government were divided into two groups, namely, preference shares and convertible preference shares. The latter, which were fixed at 30,000 shares of Rs. 100 each, were made convertible into ordinary shares, at the option of the holder, at any time between five- and twenty-five years from the date of registration of the bank. Also, the Financial Secretary was made permanently a director, but without a vote.

² *Sessional Paper I of 1937*, p. 3.

III. *The Views of the London Committee*

But the chances of a bank, which combined business of deposit with intermediate- and long-term investment financing, being approved by the Secretary of State and his advisers, were remote. The question was referred by the Secretary of State to a 'strong and independent committee' of three bank officials¹ from the City. The first reaction of the committee to the Commission's report, as well as the Memorandum and Articles of Association, was 'one of apprehension for any deposit bank founded upon the conditions set out in the Report'. In particular, they 'viewed with grave concern the provisions relating to the capital structure and to the investment powers of the proposed institution'. To meet the liability of the cumulative preference dividend on Government shares 'in the early years of the bank's existence would in our opinion', observed the committee, 'involve strain, and it is doubtful whether if prudently managed, the bank could avoid the stigma of passing its preference dividend. It must be remembered that the expenses of establishing the bank will absorb part of its capital, and that the new institution will have to compete for business with existing concerns, and make adequate provision for contingencies and the accumulation of reserves. With four-fifths of the capital of the bank issued in the form of preference shares, there might be some incentive to the Board to enter into speculative transactions with a view to increasing its earnings, or, alternatively, to omit making sufficient provision for contingencies. If the preference dividend is not paid, the

¹ The committee comprised Sir John Caulcutt, Deputy Chairman of Barclays Bank (Dominion, Colonial and Overseas Branch) and President of the Institute of Bankers, as Chairman, Mr. R. A. Wilson, General Manager of Lloyds Bank, and Mr. Crawford Gordon, London Manager of the Canadian Bank of Commerce, as members. See *Sessional Paper I of 1937*, p. 28.

liability, being cumulative, will have to be carried forward, and the prestige of the bank, as well as the prospects for the ordinary shareholders, would suffer'.¹

The committee considered the power of the bank to underwrite, subscribe to, and invest in, shares of banking and other companies 'as fundamentally unsound'. They were 'strongly of the opinion that there should be a clear distinction drawn between investment financing and deposit banking.' Although the share-holding of the bank in any one undertaking may be limited, the mere fact that it has a considerable stake in a commercial company might tend to influence its loan policy to the detriment of sound banking. When the company may be in difficulties, the bank may feel that, apart from other considerations, it has a moral responsibility to support the concern, and it may gradually be drawn into a situation where the investment of its assets, either as share capital or as advances, has assumed dangerous dimensions. Such had been the experience, during the depression, of the European countries, where the 'mixed' type of banking prevailed.

They had a similar objection against the power 'to lend money on the security of immovable property'. In an agricultural community land is likely to be the security most frequently offered to the bank, and the tendency is generally towards the granting of long-term credits. But the value of agricultural land is known to be subject to wide fluctuations and, in times of depression, when banks aim at increased liquidity, such security is frequently the most difficult to realize and the advances secured on it often become immobilized.

'For the reasons we have stated,' concluded the committee, 'we regard the recommendations of the Commission

¹ See *Sessional Paper I of 1937*, p. 30.

and the proposed Memorandum and Articles of Association as fundamentally unsuited to the formation and operation of a State-aided deposit bank in Ceylon and we cannot therefore recommend that the Government should proceed with the scheme embodied in these documents'.¹

The committee's report was referred to the Treasury and the Bank of England. Both 'agreed emphatically with the views expressed' therein and the conclusions reached. The Secretary of State also endorsed the views of the committee and communicated his decision disapproving the scheme to the Governor of Ceylon in January 1936.

But the Board of Ministers was unwilling to suffer any such summary burial of a scheme in the preparation of which so much labour and money had been expended. Sir Sorabji Pochkhanawala, too, to whom the report of the committee was communicated by the Board, rather than see the entire scheme condemned, was prepared so to amend it as to meet the more important objections of the committee. He would agree to reduce the capital, abandon the proposal for creating subsidiary local banks, and would delete the offending investment powers of the bank. The Board of Ministers drew up a fresh Memorandum generally on the lines suggested by Sir Sorabji and submitted it to the Secretary of State, hoping that the scheme as amended would be acceptable to the experts. The Board expressed its willingness to restrict the investment finance functions of the bank to agency work on behalf of the State, to admit immovable properties only as collateral, instead of as original security, for loans, and would be satisfied with branches in place of independent local banks.²

But the experts, to whom the Memorandum and the comments of Sir Sorabji were again referred, were not

¹ *Sessional Paper I of 1937*, p. 32.

² *Sessional Paper I of 1937*, pp. 42 et seq.

satisfied that there was sufficient demand for a new deposit bank in the Island.¹ They were 'opposed to the suggestion that the powers of such a bank should be widened to include those forms of industrial and agricultural financing mentioned by the Board of Ministers either for the purpose of employing its resources or of acting as agent for the lending of Government money'. The experts, however, recognized that 'there may be a real need in Ceylon for Government financial assistance, designed to help in the development of new industrial enterprises and in the re-financing of agricultural debt'.

They had no objection to special companies being organized for the exclusive purpose of providing these facilities on lines similar to two institutions established in the United Kingdom, namely, the Agricultural Mortgage Corporation, Ltd., set up under the provisions of the Agricultural Credits Act, 1928, and the Special Areas Reconstruction Association, Ltd., formed in accordance with the Special Areas Reconstruction (Agreement) Act, 1936. The former institution, the committee explained, was concerned with the granting of long-term loans against mortgages of agricultural land and buildings, and the latter, with the provision, as a temporary and special expedient, of financial facilities to persons setting up or carrying on

¹ 'After a careful review of all the facts which have been placed before us', wrote the committee on July 31, 1936, in negating the amended scheme, 'we are not convinced that there is sufficient demand for a new deposit bank, confined in its scope to legitimate deposit banking functions, to enable it to operate on a profit-earning basis.' Continuing the argument further they added: 'If the Bank, having regard to its short-term liabilities, were unable to secure adequate employment for its funds in Ceylon, it might be forced to engage in hazardous operations or to utilize an undue part of its resources in purchasing high class external securities. In the former event, it would be departing from the principles of safety, while in the latter the capital supplied by the Government would not be benefiting the country in the manner desired'. See *Sessional Paper I of 1937*, p. 49.

business in the special areas. But they agreed that the circumstances prevailing in Ceylon may not be favourable to the establishment of institutions similar in all respects to those mentioned, and the participation of the Government both in the provision of share capital and in the administration of the affairs of the companies, would have to be more direct than had been found necessary in respect of the two concerns incorporated in the United Kingdom.

It would conduce to the success of the two companies if early steps were taken to remedy the defective commercial law and the unsatisfactory position of many land titles, which, at present, allow the debtor to defeat the creditor. If, for any reason, it were found impracticable to establish two concerns, one to provide financial facilities of a long-term nature for the development of new industries and the other for agriculture, the experts were agreeable to one company undertaking both functions, which, they suggested, might be called 'The Agricultural and Industrial Credit Corporation'. The committee, though unwilling to forecast future developments, thought it at least possible that, if a concern on the lines suggested was established, the services which it will be in a position to render, combined with the reform of the existing commercial law and the gradual improvement of the position in regard to land titles, may assist in creating conditions in Ceylon more favourable to the operation of an additional deposit bank and to the raising of share capital for such a bank from private sources without recourse to Government aid. Sir Sorabji Pochkhanawala, who was then in London, and who had several conferences with the reappointed committee, expressed his general concurrence with their recommendations.¹

¹ *Sessional Paper I of 1937*, p. 52.

IV. *The London Committee's Scheme for a Deposit Bank*

But the objections of the London committee and the conversion of the chief author of the original scheme did not deter the Board of Ministers from making yet another effort. The trade delegation to the United Kingdom, which comprised the Hon'ble Mr. G. C. S. Corea and the Hon'ble Mr. H. J. Huxham took up the question once more with the Secretary of State. Thereupon the Committee of experts were once again reappointed and had joint deliberations with the delegation. These deliberations, judging by the outcome, resulted in a compromise. The delegation accepted the view of the committee that it was unsafe to mix up investment financing, in any shape or form, with deposit banking. And the committee, on being assured that steps were being taken to overhaul the defective legal system of the Island, which restricted the scope for safe banking business,¹ withdrew their objection to a pure deposit bank. The committee then drew up a scheme, which obtained the approval of the Minister as representing the Board of Ministers, for an unalloyed commercial bank of the British type, based on well tried and accepted principles of banking.

In view of the conditions prevailing in Ceylon and bearing in mind the close connection between the Government and the proposed bank, certain restrictions on its functions to be operative in the early years of its career and certain principles of banking practice, not always codified in law, were made explicit in the Memorandum and Articles of Association. They were designed not only to strengthen the hands of the management in declining certain classes of business which experience elsewhere had proved to be dangerous, but also to forestall any disappointment that

¹ *Sessional Paper XXVIII of 1937*, p. 4.

might arise through exaggerated expectations of the type of business which it could safely undertake.

A great deal of importance was attached by the committee to the restrictions with regard to loans against immovable property. Such property was not eligible as primary security, but only as collateral, secondary, or additional, security. Certain agricultural countries, where land was likely to be the security most frequently offered to the banks, had deemed it wise to impose similar restrictions. The bank must not hold any fixed, or immovable, property, besides its own premises, however acquired, for any period exceeding five years from the date of acquisition thereof, before which time, it must be disposed of outright. Not more than 50 per cent of the funds of the bank should be utilized in making advances and, of the remainder of the funds, at least 10 per cent must be kept in cash. Unsecured advances were limited to Rs. 10,000 in each case, and no loan or accommodation should exceed a period of six months except seasonal loans for purposes of agriculture, which may be granted for twelve months. Loans to directors were to be permissible only against approved security and on an express resolution being passed on the subject by a two-thirds' majority of the board. Bills of exchange, promissory notes, and similar negotiable documents must be 'accepted bills or notes endorsed by the payee so that the company (i.e., the bank) obtains the security of two signatories signing in different capacities'¹ before it may discount them or make advances against their security.

It was prohibited from engaging in general exchange operations, including dealing in bullion or specie, during the first three years after the date of registration, except with the previous written consent of the Governor of

¹ Section III v (8) of the Memorandum and Articles of Association, *Sessional Paper XXVIII of 1937*, p. 9.

Ceylon. It was the view of the committee that this consent 'should only be given when the bank has attained a position of strength and has a staff fully qualified with the expert knowledge and experience to enable it to undertake this type of work'.¹ This prohibition, however, did not apply to transactions with India. The bank was free at once to enter into the business of Indian exchange. It could also undertake such minor operations in the currencies of foreign countries as may be necessary to meet the *bona fide* personal needs of its private customers. For the first ten years of its career it must not open branches outside Ceylon, nor, without the sanction of the Governor, in Ceylon. It was free, however, to maintain agencies in any part of the world.

The nominal capital of the bank was fixed at Rs. 7,500,000. It was divided into 15,000 convertible preference shares of Rs. 100 each and 60,000 ordinary shares of the same face value. The preference shares were to be taken up by the Government at a premium of 100 per cent. The amount of the premium was to be equally divided between a published reserve fund and an un-published contingency fund. The committee explained that the un-published part of the reserve fund was an 'indispensable feature of the scheme for establishing the Bank' and that it was a normal feature of banking in Great Britain.² Of the ordinary shares 15,000 were to be offered for public subscription but only 50 per cent of their value was to be paid-up in the first instance. The bank shall not be entitled to commence business until the shares offered to the Government and the public were fully subscribed to, paid for and allotted. The opening resources of the bank would thus be a paid-up capital of Rs. 2,250,000, a reserve fund of Rs. 750,000 and a hidden contingency account of

¹ *Sessional Paper XXVIII of 1937*, p. 5.

² *Ibid.*

Rs. 750,000. Of these resources the contribution of the State would constitute 80 per cent. The preference shares would bear a non-cumulative fixed dividend of six per cent and in certain circumstances could be converted into ordinary shares. During the first five years of the lifetime of the bank, however, the two classes of shares were to rank for dividend *pari passu* according to the capital for the time being paid up on them.

Government assistance to the bank, apart from their capital contribution, would take the form of an outright gift of Rs. 275,000 towards the preliminary and other expenses incurred in connection with its formation and registration, a fixed deposit of at least Rs. 350,000 free of interest¹ for ten years or alternatively an annual grant of Rs. 10,000 for an equal period, and an interest-free fixed deposit of Rs. 100,000 for each of the first five branches it may open in Ceylon, or in the alternative an annual contribution of Rs. 3000 for a like period.

The board of directors of the bank shall comprise five directors elected by the share-holders, and the Financial Secretary (or in his absence, the Deputy Financial Secretary). The latter would remain a director so long as the Government held any shares of the bank. But, though free to take part in the deliberations of the board, he shall not have the power to vote. While the Government holds at least one-quarter of the paid-up capital for the time being of the bank, the Governor will have the right to nominate two directors out of the five voting directors. The directors other than the Financial Secretary (or his deputy) shall retire by rotation, one each year, beginning with the senior-most director. But they would be eligible for re-nomination or re-election as the case may be. The first

¹ The total Government deposits with the banks, chiefly in Ceylon and partly in India, on September 30, 1937, were Rs. 13,083,500·80. See *Ceylon Blue Book for 1937*.

board of directors, however, shall be wholly nominated by the Governor.

The directors of the bank shall not be members of the State Council, employees of the bank nor, excluding the nominated directors and the non-voting member, Government servants. If a member of the State Council or a Government servant was elected a director, he shall resign from the State Council or from Government service, within one month of such election. Except the Government nominees, each director shall hold the bank's shares of the face value of at least Rs. 5000. So long as the Government remained the registered holder of not less than 25 per cent of the issued capital, appointments of general manager, assistant general manager, secretary, and accountant of the bank, as well as the election of the chairman and deputy chairman (if any) of the board of directors, unless he was a nominated director, will require the approval of the Governor. While the Government holds any shares of the bank or has any money deposited with it, the Governor may from time to time have the accounts of the bank audited to his satisfaction, by other than the bank's auditors.

Before any dividend was declared, 20 per cent of the profits of the bank and the full amount of any premium received on the issue of shares must be credited to a permanent reserve fund until the fund was equivalent to one-half of the paid-up capital of the bank for the time being. The reserve fund shall be invested in 'trustee' securities.

In a mainly agricultural country which depended for its income on less than a handful of export crops, the importance of adequate reserve and contingency funds must be obvious and the proportion suggested by the committee does not seem too large. (The reserves of most of the exchange banks either equals or exceeds their respective paid-up capital.) In such an economy there must necessarily occur very wide fluctuations in prosperity, and banks

must consequently be prepared to face successive years of diminishing, or deficit, revenue, due to an increase in bad debts or insufficient scope for profitable, and at the same time safe, employment for their resources in times of recession in trade. The difficulty of finding a sufficiently wide range of investments, which every bank aims at, becomes acute on such occasions.

Large institutions with a net-work of branches spread over a wide area and which can consequently afford to look upon losses for some years in the case of a few of them, with comparative indifference, if the long period average showed gains, are perhaps better able to operate successfully in restricted economies, than purely local banks, whose fate was intimately tied up with the prosperity of such restricted economies. The ability of the latter to survive difficult times must be in proportion to the size of their contingency and reserve funds, which must, therefore, be *pro rata* higher than in the case of the larger banks, whose business was spread over a wide area which embraced varying economic conditions. The collapse of the first Bank of Ceylon, whose business was chiefly confined to this Island, in the coffee crisis of 1847-48, which overtook it within seven years of its commencement, as well as the failure of the Bank of Colombo to survive for more than four years, probably illustrate the difficulties which confront purely national banks in a restricted agricultural economy and emphasise the necessity for accumulating large reserve funds.

The committee stressed the importance of remedying the defects in the legal machinery of the Island, which so greatly handicapped operations of credit institutions.¹ They were also of the opinion that, if legislation could be passed introducing a system of crop mortgages, along the lines

¹ The question is receiving the attention of the Government. See *Sessional Paper X of 1939 (Report of the Sub-Committee on Commercial Legislation)*.

of those in force in certain other parts of the Empire, the ability of the proposed bank to afford assistance to the agricultural interests would be materially increased.

The final report and the Memorandum and Articles of Association of the bank obtained the approval of the Secretary of State and they were forwarded to Ceylon in July 1937. The Memorandum was subjected to certain minor amendments by the Board of Ministers. The face value of the preference, as well as of the ordinary shares was reduced to Rs. 50 each and the number of shares of each grade was doubled. In order to ensure Government control over the bank as long as they wished, on the suggestion of the Secretary of State, such powers of control were made contingent upon the Government holding at least 20 per cent of the issued capital of the bank instead of 25 per cent as suggested in the report of the committee. For, otherwise, when the whole of the originally authorized capital was issued and paid up, the ratio of the Government capital would fall to 20 per cent and the Government would, thereupon, automatically forfeit some of their powers of control over the bank. The authority to invite applications, and allot shares, was reserved to the Minister for Labour, Industry and Commerce, with a view to ensure that the shares were not allotted 'to non-Ceylonese and to persons who might be interested in having the bank run on lines which are contrary to those intended'.¹ The sale of shares held by the Government was made subject to the Government being authorized to do so by the Board of Ministers and the granting of such authority, by the latter, was made conditional upon previous consent of the State Council being obtained. Finally, the sale of any fixed property which may come into the possession of the bank could be deferred beyond the limit of 5 years on a resolution of the

¹ Speech of the Financial Secretary in the State Council. *State Council Debates*, February 15, 1938, p. 469.

board of directors being passed by a two-thirds' majority, if it was considered that such sale could not be effected without detriment to the interests of the bank.

V. The Working of the Bank of Ceylon

The draft scheme of the experts as amended by the Board of Ministers, which was put in the form of an Ordinance (No. 53 of 1938), received the approval of the State Council on March 29, 1938 and the assent of His Majesty on November 18 of the same year.

The ordinary shares of the bank were issued for public subscription in June 1939 and the bank commenced operations on August 1 of the same year. On September 21, 1939, the Governor gave his consent to the bank undertaking exchange business in sterling to the same extent as it was allowed, under the Ordinance, to deal in exchange on India. But it was discovered that this permission was of little practical value as the Ordinance required that bills of exchange and similar documents payable out of the Island must be endorsed by the payee before the bank could have anything to do with them.¹ This meant that exporters, who wished to get their bills discounted at the Bank of Ceylon, must first send them to London or to India for their due acceptance and await their return, which may take a week or more in the case of bills on India and a longer period in the case of bills on London. It was much less trouble to have the money at once by taking the bills to one of the exchange banks or to the Imperial Bank of India. The original Ordinance was, therefore, amended by Ordinance No. 45 of 1939. The amending Ordinance abrogated the restrictive clause and left it to the board of directors to decide the conditions under which the bank could deal in exchange documents.

¹ Ordinance No. 53 of 1938, First Schedule, Part II, section 3 (g).

Since the bank commenced business it has published two balance sheets, one as at September 30, 1939, i.e., at the close of the first two months, and the other as at September 30, 1940. These balance sheets show (see TABLE V below) that the bank has had noteworthy success in attracting deposits from the public. The ratio of deposits to capital and reserve as at September 30, 1940, which shows a remarkable rise when compared with the balance sheet of a year ago, is better than that of the Eastern Bank and is not far different from the ratio of the remaining exchange banks and the Imperial Bank of India.

TABLE V

PAID UP CAPITAL, RESERVE AND DEPOSITS

(Rs. 1,000,000)

	A	B	C	D	
	Paid-up Capital	Reserve	A + B	Deposits	Ratio of D to C
The Imperial Bank of India (June 30, 1940) ...	56.25	56.25	112.50	890.23	7.91
The Chartered Bank of India (December 31, 1939) ...	40.00	40.00	80.00	715.49	8.94
The National Bank of India (December 31, 1939) ...	26.67	29.33	55.00	388.88	6.94
The Mercantile Bank of India (December 31, 1939) ...	14.00	14.33	28.33	241.04	8.51
The Eastern Bank (Decem- ber 31, 1939) ...	13.33	6.67	20.00	109.36	5.47
The Indian Bank (June 30, 1940) ...	1.28	1.40	2.68	41.64	15.54
The Bank of Ceylon (Sep- tember 30, 1939) ...	2.02	0.75	2.77	4.76	1.72
The Bank of Ceylon (Sep- tember 30, 1940) ...	2.25	0.76	3.01	18.23	6.50

In the matter of the distribution of assets, however, the comparison is generally less favourable (see TABLE VI). The order of distribution of assets is different from the order evident in the balance sheets of the remaining banks. Advances to businessmen have absorbed but a negligible proportion of the resources of the bank. They are still 4.12 per cent of the deposits. After adequate provision is made for liquidity, this form of assets is universally sought by bankers because of its profitability. In the case of the exchange banks and the Imperial Bank of India advances constitute from about 35 to about 48 per cent of the deposits.

TABLE VI

PERCENTAGES OF ADVANCES, INVESTMENTS,
BILL HOLDINGS AND CASH, TO DEPOSITS

	A	B	C	D	
—	Advances	Investments	Bills	Cash in hand and at Bankers	C + D
The Imperial Bank of India (June 30, 1940) ...	47.59	41.46	5.56	16.38	21.94
The Chartered Bank of India (December 31, 1939) ...	46.53	36.76	20.97	11.75	32.72
The National Bank of India (December 31, 1939) ...	41.02	45.88	10.76	23.52	34.28
The Mercantile Bank of India (December 31, 1939) ...	35.36	41.89	18.96	18.16	37.12
The Eastern Bank (Decem- ber 31, 1939) ...	36.44	56.90	15.58	15.69	31.27
The Indian Bank (June 30, 1940) ...	73.80	20.59	?	14.22	14.22
The Bank of Ceylon (Sep- tember 30, 1939) ...	1.85	117.86	...	37.79	37.79
The Bank of Ceylon (Sep- tember 30, 1940) ...	4.12	59.05	25.65	27.04	52.69

The chief source of income to the bank has been investment in Government securities, mostly of the Government of Ceylon and partly of the Government of India. The entire deposits together with a part of its other resources remained invested in Ceylon Government securities at the close of the first two months of the bank's career. In the second balance sheet 59.05 per cent of the deposits were allotted to Government securities.

The liquidity ratio of the bank is very satisfactory. Among the banks in Ceylon the assets of the Bank of Ceylon are the most highly liquid. Its bill holdings as well as its cash constitute a larger proportion of its deposits than the corresponding ratios of the remaining banks. The two together make 52.69 per cent of the deposits. The corresponding per centage is 21.94 for the Imperial Bank of India and round about 33 for the exchange banks.

Being a unit bank its cash as well as the liquidity ratios must, no doubt, be higher than those of the remaining banks, which are all branch banks, and the proportion of advances must be correspondingly less. Nevertheless the ratio of advances to deposits must be higher than at present both in the interests of Ceylon trade and industry and that of the share-holders of the bank. The greatest part of the deposits of the bank today are loaned out to the Governments of India and Ceylon, comparatively small amounts having been lent to traders in the form of advances, and bills discounted or purchased. It may be noted that of Rs. 4.676 millions worth of bills held by the Bank of Ceylon, Rs. 4.366 millions worth are Government of India Treasury bills, only Rs. 3.10 lacs worth being trade bills.

CHAPTER VIII

THE WORKING OF THE CEYLON SYSTEM

I. *The Present Position*

UNDER the Ceylon system in its present form, it will be recalled, the Indian rupee coin and the Ceylon Government notes are unlimited legal tender. Subsidiary coins, which are of silver, nickel, or copper, are legal tender up to a limit of Rs. 5, in the case of silver, and 50c. in the case of nickel and copper. Unlike the Indian fractional money, the Ceylon subsidiary coins are on a decimal basis, the value of the smallest coin, the $\frac{1}{2}$ cent, being two-hundredth of a rupee. The sovereign had been legal tender without limit since 1852, but it was demonetized by Order in Council on August 7, 1920.¹

Though the Indian rupee is the standard coin of the Island and the final legal tender of payment it is hardly to be seen in circulation. After its disappearance in the latter part of the Great War I, it never regained its pre-war popularity and such quantities of it as still remained left the Island in part settlement of the adverse trade balance experienced during 1928-32. Since then the rupee coin has practically faded out of use and from the public mind. Even in Colombo and the larger towns it is not always accepted without hesitation. Almost the only patrons it claims today are the Indian workers on the estates who demand it when the time comes for them to return to the mainland. The place of the

¹ *Ceylon Government Gazette Extraordinary*, August 7, 1920.

rupee has been taken by the one- and two-rupee notes, the issue of which, unlike in India, was not abandoned after the war, though the immediate necessity for them had passed. Today Government currency notes comprise almost the entire media of the internal circulation.

The chief characteristics of the system are derived from the Order in Council of 1869, the Paper Currency Ordinance of 1884, and the amendments to the latter, in particular, Ordinance No. 6 of 1903 and Ordinance No. 1 of 1917. They may be summarized as follows:—

1. The Indian rupee coin is unlimited legal tender and, so far as the law provides, is inconvertible into any other coin or foreign currency.

2. Ceylon Government notes are convertible into Indian rupee coins, and the notes can likewise be had in exchange for the Indian coins, on demand, at the office of the Commissioners of Currency in Colombo, at the nominal par.

3. The Commissioners of Currency may also issue notes 'in exchange for the amount thereof in gold coin which is legal tender in Ceylon under any Order of His Majesty the King in Council' (i.e. sovereigns); but they may decline to do so if they considered it inexpedient to increase the gold part of the reserve (Ordinance No. 6 of 1903).

4. Until such time as the Governor may notify to the contrary in the *Government Gazette*, the Commissioners could issue notes against credits at the Bank of England, as if they represented so much gold coin, but with the approval of the Secretary of State and in amounts permitted by him (Ordinance No. 1 of 1917).

The second of the provisions links the Ceylon rupee to

the Indian rupee coin. It ensures that the value of the two currencies shall not deviate from par in either direction by more than the cost of remitting rupee coins to Ceylon, in the one case, and in the opposite direction, in the other. The Island being so close to India the discount or premium on either of the currencies against the other rarely, if ever, exceeds one-fourth per cent, which is about the upper limit of the cost of moving silver specie for the banks.

Provision (3), legally speaking, ceased to be in force after the demonetization of the sovereign, by Order in Council, in August 1920. Thereafter, it lost its meaning, though Ordinance No. 6 of 1903 was not expressly repealed. Sovereigns not being any longer legal tender could not legitimately be received into the reserve¹ by the Commissioners nor could they issue notes against them. For this purpose Indian rupee coins alone were eligible.

Provision (4) is closely related to provision (3). Also its applicability, like that of provision (3), did not survive the demonetization of the sovereign. For, sterling credits could not continue to enjoy the privilege of acting as part of the coin reserve when such privilege was withdrawn from their principal the sovereign. But the provision, as we shall see presently, greatly influenced the course of currency policy and practice in the Island.

II. *The Working of the System before the Great War I*

Before the Great War I the working of the system was almost wholly governed by provision (2). The lowest denomination of the notes being Rs. 5, rupee coins, as in

¹ See section 12 of the principal Ordinance as amended by section 4 of Ordinance No. 13 of 1901.

India, formed a large proportion of the total circulation. Increased demand for currency was met by the importation of rupee coins, which were either passed into circulation, or were offered to the Currency Commissioners in exchange for notes. Likewise, when an adverse trade balance demanded remittance of funds in settlement of it, (or after the imported Indian funds had done their duty and were wanting to go back to India), rupees were withdrawn from circulation or demanded from the currency authority and shipped to India. When rupees flowed in, the total quantity of money in circulation increased by an equivalent amount, partly the metallic portion of it, and partly the paper circulation, through the issue of notes obtained in exchange for the rupee coins. Similarly, when funds, on balance, left the Island, the note circulation diminished by the amount offered to the Currency Commissioners to obtain rupees for export. Consequently, currency movements before 1914 were more or less automatic, import or export of specie governing the total quantity of the monetary circulation.

The chief part in this movement of specie was played by the banks or rather the Bank of Madras, through whom the exchange banks, as explained in a previous chapter, found it convenient to operate. Perhaps the Bank of Madras was also in a position to ship rupees in both directions at lesser expense than the exchange banks (except, probably, the National Bank)¹ as it had a branch in Tuticorin, which was very close to the Island. But the Chettiar bankers played an important part as well. Through the use of the country craft, which the banks did not dare to make use of, they

¹ The Tuticorin branch of the National Bank commenced operations in 1901.

were able to transport rupees at a cost which was a fraction lower than the cost for the banks.¹ The Chettiars, therefore, generally acted on their own to meet the demands of their customers, or of their own requirements, rather than approach the Bank of Madras. A small part of the specie was also carried by the petty traders, workers, and others. But this movement was chiefly out of the Island and was not directly related to the general trend of trade.

Another feature of the system before the Great War I was that the coin portion of the reserve was more usually below 50 per cent than above it, so that the device of issuing notes against the purchase of securities was not frequently open to the Currency Commissioners. For, it will be recalled, the Paper Currency Ordinance prohibited additions being made to the investments held in the reserve, when the specie part of it fell below one half of the notes outstanding. When the busy season arrived, there was thus no surplus in the coin reserve. On the contrary, on such occasions, the reserve was nearly always below the legal minimum and the currency authority was powerless to respond at once to the increased demand for money.

It had to wait until the rising tempo of trade brought in its course sufficient rupees from India, the rupees so brought reached the currency office in exchange for notes, and the reserve, as a consequence, gradually rose up to, and passed, the 50 per cent limit. Till then the Commissioners could only look on and merely play the passive role of converting coins into equivalent notes. When a free margin of the rupee reserve appeared, it was usually the peak of trade

¹ The usual cost for the Chettiars was Rs. 2 per bag of Rs. 2000 or $\frac{1}{10}$ per cent (Evidence of Alagappa Chetty before the Ceylon Currency Commission, *Sessional Paper V of 1903*, p. 47) while the banks paid as much as $\frac{1}{4}$ or $\frac{5}{16}$ per cent (Evidence of F. Bennett and R. Wilson, *Sessional Paper V of 1903*, pp. 34 and 42).

activity and the seasonal demand for money was at its highest. Consequently, the Commissioners lost no time to increase their investments to the limit permitted by law. The procedure suited their own interests as well since additional securities in the reserve meant increased profits. The securities purchased usually equalled the surplus coin receipts so that the note circulation increased by twice the quantity of the surplus coins acquired and the reserve ratio, as a result, once again fell to 50 per cent.

As the seasonal activity relaxed, the rupee coins, which had come in, in the wake of the rising trade, started returning to the mainland and the currency authority could do no more than once more play the passive role, this time surrendering coins for notes. It was unable, even if it wished, or the interests of the country required it, to neutralize the contraction of the circulation, which followed the export of specie, by issuing an equivalent amount of notes against the purchase of securities. As the season advanced into the dull season, wastage of the reserve continued until, in the summer months, it reached a low ebb.

Currency movements before 1914, then, notwithstanding the proportional reserve system of issue, behaved more or less as if it were on a fixed fiduciary issue basis. The rise or fall in the volume of money was measured by the quantity of inflow and outflow of rupees. Consequently, the coin reserve and the note circulation kept step and moved up, or down, together. Room for secondary expansion of currency, as distinguished from the primary expansion caused by the exchange of rupee coins for currency notes of an equal amount, was not always present and, except during short intervals of peak seasonal activity, when a free margin of the reserve was usually available,

such expansion seldom took place. The rupees in the reserve, and the note issue, fell in the summer months when trade was dull. The banks then sent back the funds which they had imported temporarily from India and the workers on the estates converted their wages into rupees before commencing their annual migration to the mainland. Likewise, both reached their highest point during the busy season, which usually lasted from October to January.

The above movements emerge with great clearness from the monthly statements published by the Commissioners of Currency. The table opposite gives the figures for 1911-1913.¹ In January 1913, the note circulation and the coin reserve were Rs. 226.35 lacs and Rs. 106.46 lacs, respectively. In May the note circulation declined by Rs. 16.65 lacs and the coin reserve fell by an identical amount. The security reserve remained undiminished during the interval at Rs. 119.88 lacs. In July the notes rose to Rs. 247.13 lacs, or by Rs. 37.43 lacs, specie reserve increased by the same amount, and the securities remained unaltered at the January figure. The withdrawal of rupees from the reserve as between January and May brought down the coin ratio from 47.03 per cent in January to 42.83 per cent in May. Their return to the Commissioners raised the ratio to 51.49 per cent in July. But the surplus amount of the reserve was small (Rs. 367,955.91), and secondary expansion of currency was deferred until after further quantities arrived in August and September. In October the coin reserve reached Rs. 150.24 lacs, which, compared with the position in July, meant an increase of Rs. 23.00 lacs and a surplus reserve of Rs. 26.68 lacs. It was utilized as a basis for

¹ For the rest of the pre-1914 period see Appendix I.

increased currency issue : the Commissioners added to their investments Rs. 31.73 lacs worth of securities, so that, the note circulation rose by Rs. 54.73 lacs to Rs. 301.86 lacs as between July and October, i.e., it rose by the amount of the securities bought plus the amount of the additions to the coin reserve. Secondary expansion brought down the reserve ratio to 49.77 per cent.

The figures for 1911 and 1912 reveal an almost identical movement. The differences, if any, are of minor significance. The note circulation touched its lowest point in May for the year 1912 and in June for the year 1911, and secondary expansion of currency, in both years, did not take place until November. In 1913 this had begun as early as August. The peak figure of the note circulation was reached in October, during 1912 and 1913, while, in 1911, it had not been reached until November. Such minor differences apart, the cyclical movement, with a more or less automatic regularity, held true of practically the entire period before the Great War I (see chart facing p. 158 below).

III. *The Beginnings of the Exchange Standard*

The period before 1914, though it was dominated by the rupee coin, also saw the beginnings of the policy of dealing in exchanges which was destined to become a feature of increasing importance during and after the Great War I. The Currency Commissioners, as well as the banking system, were soon tired of moving rupee coins backwards and forwards and, whenever opportunity offered, preferred, instead, the more convenient method of serving the same end through dealings in exchange. The following table gives details of the more important cases of the issue of

notes by the Commissioners against the pledge of sterling or rupee exchange :—

TABLE VIII
ISSUE OF CURRENCY AGAINST STERLING AND RUPEE
EXCHANGE

Source : Monthly Statements of the Currency
Commissioners

(Rs. 100,000)

Date	Net increase in the currency issue			Currency notes issued against :				
	Notes	Coins	Total	Rupee coins	Rupee ex- change	Sterling ex- change ²	Long-term Securities ¹	
							Rupee	Sterling
Sep. 1903	14.80	0.20	15.00	...	...	15.00	...	...
Oct. 1903	7.90	1.60	9.50	...	...	3.50	6.00	...
Nov. 1903	11.13	...	11.13	3.13	...	2.00	6.00	...
Aug. 1913	33.60	...	33.60	17.70	...	15.90	...	3.83
Sept. 1913	8.73	...	8.73	3.90	...	1.00	...	...
Oct. 1913	12.40	...	12.40	1.40	...	11.00	...	...
Jan. 1917	54.10	5.90	60.00	...	...	60.00	...	...
Jun. 1917	30.50	...	30.50	0.50	...	18.50	11.50	...
Aug. 1919 ³	30.00	...	30.00	10.00	20.00	...	...	...
Dec. 1919	60.31	...	60.31	20.30	...	...	40.00	0.01
Jan. 1920	30.08	...	30.08	0.08	...	30.00	...	...
Oct. 1924	9.96	0.04	10.00	...	10.00	...	...	...
Sep. 1925	49.97	...	49.97	...	...	40.00	9.97	...
Oct. 1925	29.94	0.06	30.00	...	...	20.08	...	9.92
Sep. 1926	19.16	0.84	20.00	...	...	20.00	...	...
Aug. 1934	10.24	...	10.24	0.24	...	10.00	...	...
Nov. 1934	9.96	0.04	10.00	...	...	10.00	...	...
Mar. 1937	19.96	0.04	20.00	...	...	20.00	...	...
Sep. 1937	19.98	0.02	20.00	...	...	20.00	...	...
Sep. 1939	39.54	0.46	40.00	...	40.00	...	...	...
May 1940	20.04	...	...	0.04	20.00	...	...	...

¹ The securities in this column represent investments of liquid assets received in exchange for the note issue.

² The amount in this column represents bank deposits in England held by the Crown Agents on behalf of the Commissioners of Currency.

³ The security holdings in the reserve for this month show an increase of Rs. 32.84 lacs which represents the amount of the Depreciation Fund transferred to the General Reserve Fund.

In August 1903, the surplus coin reserve was Rs. 14.77 lacs and the Commissioners, apparently, did not wish to augment their coin holdings any further. In the following month, therefore, when there was a demand for additional currency, they released from the coin reserve Rs. 20,000 worth of coins and issued Rs. 14.80 lacs worth of notes against Rs. 15 lacs worth of sterling exchange. The process of issuing notes against exchange (this time partly sterling credits and partly rupee credits) was repeated in October, and also in November, of the same year. Circumstances favourable to the issue of notes against exchange did not recur until August 1913, in which month the note issue increased by Rs. 33.60 lacs. As the coin in the vault was now fairly above the legal minimum, the new issue was balanced by an increase of Rs. 17.70 lacs to the coin holdings and an addition of Rs. 15.90 lacs worth of sterling credits to the investment part of the reserve.¹ That is to say, the Commissioners accepted for the notes only so much coin as was necessary to keep the coin ratio safely above the legal limit and preferred payment for the rest in sterling exchange. The policy of issuing notes against sterling credits was repeated in September and, on a larger scale, in October, of the same year.

This policy, convenient in time of peace, was found to be exceedingly suitable to the exigencies of the war, and the immediate post-war position. During 1914, and 1916, the metallic reserve was below 50 per cent and every addition to the note circulation had, therefore, necessarily to be against the tender of rupee coins. But, in order to meet the requirements of war exports, expansion of currency had to take place at a faster pace than this tardy process would

¹ It will be noted from the table that, during this month, the assets side increased by Rs. 3.83 lacs more than the note issue. It is not clear how this was brought about. But the discrepancy was set right in September 1913, the statement for which month shows an increase in the note issue by Rs. 3.83 lacs more than the additions made to the assets.

permit. The issue was brought to a head by the difficulty of disposing of sterling credits in India against rupees and, as we have seen elsewhere, before the beginning of 1917, the Commissioners had found themselves jockeyed into a position from which they had no way of escape but to issue notes in exchange for sterling. The monthly statements for 1917, 1918, 1919, and part of 1920, accordingly, show sterling deposits held in London by the Crown Agents as part of the specie reserve, as if they represented sovereigns.

Circumstances favourable to the issue of notes against exchange arose again in October 1924. In the previous month the excess coin reserve had risen to Rs. 69.02 lacs and the Commissioners did not wish further to increase their stock of the coin. Accordingly, they received payment for Rs. 10 lacs worth of currency demanded by the community (a small part of the demand they met in rupee coins) in rupee credits which were shown as 'Cash at call in Madras pending investment' in their monthly statements. Similarly in September 1925 a jump in the note issue of Rs. 49.97 lacs was balanced partly by rupee credits in Madras and partly by sterling credits, which latter were described as 'Cash at call, London, pending investment'. In October 1925 and September 1926, when increased currency was again demanded, so far from making any additions to the coin reserve, a part of the demand was met in rupee coins.

Since then the note circulation having remained steady, or declined, the question of the expediency of issuing notes against exchange did not recur until the latter half of 1934. In August of that year, notwithstanding the fact that the rupee reserve was then below the one-third minimum,¹ the Commissioners issued Rs. 10.24 lacs worth of

¹ The statement for July 1934 showed a deficit of Rs. 1.36 lacs.

notes chiefly against sterling exchange: they received only Rs. 24,000 worth of rupee coins. Virtually the same process was repeated in the following November. Hitherto the policy of issuing notes against sterling credits had been applied only to situations when the reserve was in excess of the legal ratio and the Commissioners did not wish to make any further additions to it. But now they were willing to do the same even when the coin reserve was below the legal minimum. In March and September 1937, and later, after the outbreak of the present war, they had opportunities to restore the legal minimum ratio by insisting upon having only rupee coins before issuing notes. But they continued to prefer exchanges to silver rupees. They accepted, in return for equivalent notes, Rs. 40 lacs worth of sterling in 1937, and, in September 1939, issued Rs. 39.54 lacs worth of notes and Rs. 46,000 in coins against Rs. 40 lacs worth of rupee credits in Madras. Similar transactions were repeated in November and December of the same year and in May 1940¹.

IV. *The Proportion between Rupee and Sterling Securities*

This policy had important practical consequences. It affected the balance between rupee and sterling securities in the reserve, the manner of convertibility of the notes and, ultimately, the Commissioners' faith in the utility of the coin reserve. The table on pp. 162-63 below roughly indicates the effect of the policy on the distribution of the investment reserve as between rupee and sterling securities. The following comments, however, are based upon fuller details which will be found in Appendix I.

¹ For an account of currency expansion during the present war see B. B. Das Gupta, 'Expansion of Currency in Ceylon,' *C. E. J.*, December 1940.

TABLE IX

SECURITIES IN THE CURRENCY RESERVE AT
DECEMBER 31 EACH YEAR

Source: Monthly Statements of the Currency
Commissioners

(Rs. 1,000,000)

	A	B	C		
Year	Rupee securities	Sterling securities	Total securities	Percentage of A to C	Percentage of B to C
1900	3.51	3.51	7.02	50.00	50.00
1901	do.	do.	do.	do.	do.
1902	3.38	2.57	5.95	56.81	43.19
1903	4.58	4.62	9.20	49.78	50.22
1904	2.21	do.	6.83	32.36	67.84
1905	2.31	do.	6.93	33.33	66.67
1906	4.61	4.63	9.24	49.89	50.11
1907	do.	do.	do.	do.	do.
1908	4.01	4.63	8.64	46.41	53.59
1909	do.	do.	do.	do.	do.
1910	5.24	5.62	10.86	48.25	51.75
1911	5.74	do.	11.36	50.53	49.47
1912	do.	6.01	11.75	48.85	51.15
1913	do.	9.42	15.16	38.16	61.84
1914	do.	do.	do.	do.	do.
1915	do.	do.	do.	do.	do.
1916	do.	12.42	18.16	31.87	68.13
1917	9.89	9.42	19.31	51.27	48.73
1918	do.	do.	do.	do.	do.
1919	14.88	14.12	29.00	51.31	48.69
1920	17.72	12.19	29.91	59.20	40.80
1921	15.25	13.45	28.70	53.14	46.86
1922	18.09	8.15	26.24	69.08	30.92
1923	do.	12.23	30.32	59.66	40.34
1924	19.08	12.26	31.34	61.02	38.98
1925	20.08	15.80	35.88	55.96	44.04
1926	20.10	24.73	44.83	44.87	55.13
1927	20.08	24.76	44.84	44.78	55.22

TABLE IX (*continued*)

(Rs. 1,000,000)

	A	B	C		
Year	Rupee securities	Sterling securities	Total securities	Percentage of A to C	Percentage of B to C
1928	17·71	22·04	39·74	47·10	52·90
1929	17·74	do.	39·77	44·73	55·27
1930	do.	21·92	39·66	42·21	57·79
1931	11·05	22·03	33·08	33·40	66·60
1932	do.	22·37	33·41	32·93	67·07
1933	do.	22·72	33·77	32·72	67·28
1934	do.	23·26	34·31	32·08	67·92
1935	do.	24·98	36·03	30·67	69·33
1936	do.	25·23	36·28	30·46	69·54
1937	do.	29·58	40·63	27·20	72·80
1938	10·82	29·57	40·29	...	100·00
1939	10·32	35·97	46·29	22·29	77·71

Before 1913 the usual practice had been to maintain more or less a fifty-fifty ratio between the rupee and sterling securities. Whenever this ratio was disturbed the Commissioners usually took the first opportunity to restore the even balance. The change in this policy dates with the autumn of 1913 and seems to be related to the practice of issuing notes against sterling. For the first seven months of that year rupee and sterling securities remained at Rs. 57·40 lacs and Rs. 62·48 lacs, respectively. In August, September and October, when secondary expansion of currency took place, additions were made only to the sterling securities, which increased by Rs. 31·73 lacs to Rs. 94·21 lacs. Rupee securities remained unchanged throughout the year.

The war and the immediate post-war period brought with them special problems of their own, which we have

reviewed elsewhere, and the policy of the Currency Commissioners was necessarily conditioned by them. Currency history during the period, therefore, must be viewed as a part by itself and must not be taken as a continuation or a reversal of the general trend of policy detectable under normal conditions. Thus, the addition of sterling assets to the investments, in December 1916, was not a continuation of the policy, pursued in the autumn of 1913, nor was the increase in the rupee securities in the middle of 1917 to Rs. 98.90 lacs, which amounted to a restoration of the pre-1913 ratio between the two groups of securities, any permanent reversal of that policy.

Both transactions, like those which followed them, were the result of the exigencies of the circumstances created by the war. The purchase of sterling assets in 1916 was not out of any choice, as in 1913, but was more or less inevitable. And the increase in the holdings of rupee securities later was the most expedient course to follow under the prevailing circumstances. The Indian exchange market, as seen elsewhere, was over-stocked with sterling and the banks were experiencing the greatest difficulty in disposing of their sterling bills in order to shift their funds to their Indian and Ceylon branches from London. Also the sterling value of the rupee was steadily on the increase—it rose from 1s. 5d. in August 1917 to over 2s. 4d. in January 1920—and the rupee value of sterling securities, as a consequence, was *pro rata* on the decline.

Under these circumstances, sterling assets could not be sold in an emergency except at a heavy loss, and it was considered safe to have in the reserve sufficient rupee securities so as to enable the importation of rupee coins from India when required. The pre-1913 relation between the two groups of securities, therefore, was restored in the

latter half of 1917, which, except for a temporary break in the autumn of 1919, was maintained until the spring of 1920.

In February of the latter year, there arose in India a keen demand for remittances to London and the rise in the rupee-sterling rate showed a definite tendency to be reversed. Indeed, the attempts of the Indian Government to support the rate, first at the level of 2s. *gold* and later, in June 1920, at 2s. *sterling*, through the sale of bills on the Secretary of State (Reverse Councils), proved an utter failure.¹ During this period, the consideration for keeping sufficient rupee securities in the reserve being no longer present, the Currency Commissioners resumed the policy of preferring sterling securities for the investment of their funds.

But the policy had soon to be suspended once again. For, while on the one hand the exchange seemed to be determined to remain below 2s. *gold*, on the other, the Indian Government appeared to be equally determined to accept the recommendation of the Babington Smith Committee (1919), and to officially fix the value of the rupee at that rate. This meant that, whatever the market rate of exchange, when the proposed legislation became law the new ratio had to be adopted for accounting purposes. In the books of the Commissioners sterling assets were rated at 1s. 4d. per rupee so that a 2s. rate would bring about a considerable fall in their book value. They were, therefore, unwilling to add to their difficulties by purchasing any more sterling assets. Indeed, the surplus currency assets being insufficient to cover the 'loss' which would follow the adoption of the new ratio, the balance sheet

¹ *Report of the Royal Commission on Indian Currency and Finance, 1926*, para. 8.

requirements of the Commissioners demanded conversion of sterling assets into rupee assets.

This they proceeded to do in July 1920, after it became abundantly clear that the 2s. gold rate could not be maintained. At the moment the Crown Agents held on behalf of the Commissioners a large amount of liquid funds in cash and in Treasury bills. This was remitted to Madras and a note attached to the statement of accounts for the month (July) explained that, 'the Treasury bills have been rediscounted and the proceeds, together with the cash at call in L. C. W. and Parr's Bank, have been remitted to Madras to be used for shipping rupees to Ceylon'. And the statement for August included on the assets side a fresh item entitled, 'cash at call at Madras, pending shipment of rupees' of the value of Rs. 54.82 lacs, which, apparently, represented the amount transferred to Madras from London.¹

In September the Imperial Legislative Council of India passed the necessary legislation fixing the value of the rupee at 2s. gold. The adoption of the ratio by the Currency Commissioners in Ceylon, as noted in a previous chapter, resulted in the currency assets falling short of the currency notes in circulation by about Rs. 35 lacs. Also the sterling rate of the rupee was fluctuating considerably. From August 1921 to September 1924, it varied between 11½d. and 1s. 3½d. gold. Under these circumstances to purchase sterling assets at the market price and to enter them in the books at the rate of 2s. per rupee would have

¹ But only Rs. 30 lacs of this amount was utilized for the importation of rupees from India, 10 lacs of rupees being imported in each of the months of September, November, and December, 1920. Incidentally, this seems to be the first time when the Commissioners had imported rupee coins on their own. Hitherto, the amounts received from the banks or the public had been sufficient for all purposes.

considerably aggravated the position at a time when it was necessary to make every effort to redress the deficit in the total currency reserve. The Commissioners, therefore, in addition to applying the funds, received for the notes, which were issued from time to time, towards the purchase of rupee securities, resolutely pursued the policy of converting sterling securities into rupee securities. This resulted in a great disparity in the amounts of the two groups of securities, which was the widest in November 1922, when the rupee investments totalled Rs. 180.86 lacs and sterling investments fell to Rs. 81.52 lacs.

The uncertainties of the exchange position terminated with Great Britain's return to gold in April 1925, and the simultaneous *de facto* stabilization of the Indian rupee at the rate of 1s. 6d. per rupee. It enabled the Commissioners to resume, this time without a break, their old policy of preference for sterling securities. Beginning with October 1925, the proceeds of the issue of notes were wholly invested in them and, as a result of the phenomenal increase in the note circulation, which soon followed, sterling investments in the currency assets outstripped the rupee investments. In March 1926, the former reached Rs. 213.16 lacs, whilst rupee securities remained at their 1925 level of Rs. 200.80 lacs. No addition was made to them in 1927 either. But sterling securities kept rising and early in 1928 reached Rs. 247.56 lacs.

As a corollary to this change of emphasis on sterling in the reserve, the Commissioners preferred to liquidate rupee investments, whenever cash was needed to redeem notes. The process began in March 1928, and rupee securities fell to Rs. 110.45 lacs in June 1931. They remained at this level until the middle of 1938. During the interval, the proceeds of the increased note circulation were all invested in sterling. The policy of reducing holdings

of rupee paper was pushed further in the latter half of 1938. In July of that year, the Commissioners disposed of the greater part of the rupee securities which were consequently reduced to Rs. 40.84 lacs. This was done not for redeeming notes, as on former occasions, but for re-investment in sterling securities. At first the proceeds were kept in liquid form as balances in the Joint Colonial Fund. But as opportunity offered they were converted, by December, into sterling stock. Again, in September and December of the same year, by two stages the remaining rupee securities in the reserve were liquidated, and for the first time since the introduction of the Government paper currency, in 1885, the invested portion of the reserve wholly comprised sterling securities.

Rupee securities, however, reappeared early in the present war. The first war-time expansions of currency, as noted above, were effected against rupee credits. These were invested in Indian Treasury bills or Government of India Loans. Indian (rupee) securities in the reserve rose from Rs. 19.87 lacs in October 1939 to Rs. 169.39 lacs in March 1940. The increase in the rupee securities was larger than the rise in the note circulation, as the Commissioners, simultaneously, converted part of their holdings of sterling securities into rupee securities. Their stock of the former declined from Rs. 402.90 lacs in October 1939 to Rs. 313.37 lacs in February 1940.

V. The Effect of the New Policy on the Coin Reserve

Before the 1914-war, though the coin in the vault was never considerably above 50 per cent of the note liability and was very often below it, it was always vastly above the one-third ratio. This can be seen from the following

table which refers to the position as at the close of each financial year :—

TABLE X

GROSS NOTE CIRCULATION AND COIN RESERVE

Source : Monthly Statements of the Currency Commissioners

(Rs. 1,000,000)

	A	B	C
September 30	Gross note circulation	Coin reserve	Percentage of B to A
1900	12·94	6·64	51·31
1901	12·16	5·14	42·27
1902	12·24	6·29	51·39
1903	16·32	8·88	54·41
1904	13·71	7·08	51·64
1905	12·33	5·41	43·88
1906	15·47	7·66	49·52
1907	17·37	8·13	46·80
1908	15·34	6·71	43·74
1909	16·93	8·29	48·97
1910	22·73	12·67	55·74
1911	22·64	11·78	52·03
1912	22·79	11·29	49·54
1913	28·95	14·88	51·40
1914	27·90	12·74	45·66
1915	27·33	12·16	44·49
1916	27·89	12·72	45·61

Consequently the Commissioners were able to meet, and had almost invariably met, the demand for conversion of the notes in rupee coins.

The policy of issuing notes against exchange, however, inevitably affected the coin reserve. It never regained its pre-1914 proportion of 50 per cent, but remained round about the one-third ratio, as is brought out by the following table which refers to the position as at the close of each financial year :—

TABLE XI

GROSS NOTE CIRCULATION AND COIN RESERVE

Source : Up to 1928 *Reports of the Colonial Auditor* ;
thereafter *Reports of the Auditor-General*

(Rs. 1,000,000)

	A	B	C
September 30	Gross note circulation	Coin reserve	Percentage of B to A
1921	45·74	14·86	32·49
1922	39·30	do.	37·81
1923	42·71	18·27	42·78
1924	47·00	22·57	48·02
1925	52·98	22·55	42·56
1926	61·73	24·30	39·36
1927	62·47	24·05	38·50
1928	57·44	22·51	39·19
1929	57·33	22·40	39·07
1930	57·22	22·29	38·95
1931	42·44	14·26	33·60
1932	41·97	13·79	32·86
1933	42·03	13·85	32·95

TABLE XI (*continued*)

(Rs. 1,000,000)

	A	B	C
September 30	Gross note circulation	Coin reserve	Percentage of B to A
1934	43·08	13·91	32·29
1935	44·15	13·97	31·64
1936	44·33	14·16	31·94
1937	48·39	14·21	29·37
1938	45·08	14·40	31·95
1939	49·16	14·48	29·46

This in its turn was bound to influence the manner of redemption of the currency notes. For, the reserve could not be drawn upon freely without driving the cash ratio below the rock-bottom one-third minimum, except when the amount of the notes returned to the Commissioners was small.

VI. *The Redemption of Notes in Exchanges*

The table on p. 172 below gives details of the more important cases of redemption of the notes in rupee or sterling exchange or long-term securities.¹

¹ It will be noted that, except in July 1920, March 1928, February 1931, September 1938, the aggregate value of the currency assets liquidated does not balance with the value of the notes redeemed. This is due to the securities being valued at their cost price. In April 1922, however, in which case the two magnitudes show a wide disparity, special circumstances provide the chief explanation. Sterling stock was then valued in the books of the Commissioners at the rate of 2s. per rupee while the market rate of exchange during the month remained fractionally above 15d. per rupee. Also, when sold, it realized a premium. See *Report of the Colonial Auditor, 1921-22*, para. 161.

TABLE XII

REDEMPTION OF THE NOTE ISSUE

Source: Monthly Statements of the Currency Commissioners and *Report of the Auditor-General, 1937-38*

(Rs. 100,000)

Date	Net return of notes to the Currency Commissioners	Redeemed in :			
		Rupee coins	Sterling	Securities ¹	
				Rupee	Sterling
Jul. 1920 ...	18.08	...	18.08	...	...
Apr. 1921 ...	24.61	...	...	24.67 ²	...
Apr. 1922 ...	64.58	0.02	...	...	36.98 ³
Mar. 1928 ...	25.22	0.22	...	25.00 ⁴	...
Feb. 1931 ...	52.54	15.04	...	37.50 ⁵	...
Mar. 1931 ...	57.52	37.52	...	...	...
Jun. 1931 ...	18.97	8.97	...	9.35 ⁶	...
Sep. 1938 ...	34.80 ⁷	...	34.80	19.52 ⁸	...
Feb. 1940 ...	19.88 ⁹	...	...	19.88 ¹⁰	...

¹ The securities are valued at cost.

² Indian six months' Treasury bills; part of the sale proceeds, after meeting the notes presented for encashment, were invested in sterling securities (Rs. 4.11 lacs).

³ War Loan 5 per cent.

⁴ Chiefly Government of India 6 per cent Loan and partly Government of India 6 per cent Bonds.

⁵ Indian 5 per cent War Loan.

⁶ Indian 5 per cent War Loan.

⁷ Actually the amount of the notes presented for redemption was Rs. 35 lacs. They were wholly met in sterling exchange (See *Report of the Auditor-General, 1937-38*, para. 456). Subsequently Rs. 20,000 were deposited with the Commissioners and equivalent notes were taken out so that the net contraction of the note circulation for the month was Rs. 34.80 lacs.

⁸ Indian 5 per cent War Loan.

⁹ The actual contraction of currency was Rs. 20 lacs, as, during the month, Rs. 12,000 returned to the Commissioners in coins. The whole amount was met in rupee credits.

¹⁰ 'Cash at call, Madras.'

The first time when the problem of redemption seriously presented itself to the Commissioners was during the post-war depression. In July 1920, Rs. 18.08 lacs worth of notes were handed in by the Bank of Madras for encashment. But the coin reserve at the time, as shown in the statement for the preceding month, was over Rs. 28 lacs short of the one-third ratio. That is to say, there was already present the problem of finding enough rupees to restore the legal ratio. It was not possible, therefore, to give to the Bank of Madras rupee coins in exchange for the notes. They were met, instead, out of the liquid sterling assets (Treasury bills and cash at call in L.C.W. and Parr's Bank) held by the Crown Agents on behalf of the Commissioners.

In April of the following year Rs. 24.61 lacs worth of notes were again returned to the Commissioners, and as the coin reserve had once more fallen short of the legal ratio, the notes were met by realizing Rs. 24.67 lacs worth of rupee securities. After meeting the demand for conversion in full, the balance of the sale proceeds was invested in sterling securities. In April 1922, there was another contraction of the note circulation of the value of Rs. 64.58 lacs. A negligible amount of it (Rs. 1971) was met in rupee coins but the rest was redeemed by the sale of sterling securities of the book value of Rs. 36.98 lacs.¹

A similar situation arose in February and March 1928 and was similarly met. Such amounts of rupee coins as could safely be taken out of the reserve were paid out and the rest of the notes were redeemed in exchange raised by the sale of rupee securities. The return of currency during the 'September crisis' of 1938, which affected Ceylon with the greater part of the world, and during February

¹ See footnote 1 on p. 171.

1940 was met, the former in sterling drafts on the Crown Agents,¹ London, and the latter in rupee drafts on Madras.

VII. *The Advantages of the Exchange System*

Thus the working of the system has shown marked leanings towards the technique of an exchange standard. The first signs of it appeared in September 1903. The practice of issuing notes against exchange was readopted in 1913 and was extensively employed in the latter part of the Great War I. The amendment of 1917 legalized the issue of notes against sterling credits in London even when the coin reserve was below the legal minimum. Thereby it grafted on to the pre-1914 system part of the framework of the exchange standard. The framework of the standard was completed when the Commissioners discovered, by experience, during the post-war currency contraction, that they could as successfully redeem notes in exchanges as in rupee coins. Thereafter the conversion of notes into rupee coins and rupee coins into notes gradually receded into the background and, in recent years, this practice has all but ceased. Dealings in exchange have taken the place of dealings in coins. The issue of notes against sterling credits and the redemption of notes either in sterling or in rupee exchange has become the most general practice. Whether the Commissioners offer in exchange for the notes either sterling or Indian exchange depended upon, which group of securities it was convenient or advantageous to dispose of, or upon the investment policy which they were pursuing at the time the notes were presented for conversion. Probably, they also consulted the wishes of the Imperial Bank on the subject.

It is an excellent instance of how practical convenience and natural economic forces, in course of time, evolve the

¹ *Report of the Auditor-General, 1937-38, para. 456.*

most suitable system for the country, permissible under the circumstances. It illustrates how these forces have managed to get the better of a law fifty-five years old. The exchange system, which has been gradually taking shape in the Island during the past two decades or more, grew because of its inherent advantages. It was eminently suitable to both parties to the transaction. It enabled the banking system at once to transfer its funds from London to Colombo. It was no longer necessary for the banks, as a final solution of their transfer problem, to wait for the funds until their holdings of sterling were converted into rupees and the shipment of rupees arrived in Colombo. Similarly when it was a question of remitting funds, on balance, out of the Island, exchange offered in return for the notes suited their purpose better than a quantity of coins delivered locally. In 1920, 1922, and 1938, when sterling was offered by the Commissioners for the notes, the Imperial Bank accepted it willingly as, on these occasions, there was a keen demand for sterling in India for the purpose of remittance abroad.

This arrangement suited the Government as well. Sterling credits deposited with the Crown Agents in London, or rupee credits in India, served the policy of investing the proceeds of the note issue in sterling or rupee securities very much better than rupee coins taken delivery of in Colombo. Also, conversion of notes into sterling drafts or rupee exchange saved them the expense of importing rupees from India to pay them out again to the holders of notes. By experience they had found that investments in their assets, which brought them an income by way of interest but which the coins did not, served their requirements just as well as rupee coins in the vault. In times of emergency, the Commissioners had met with little difficulty in disposing of securities to meet the demand for conversion of the notes.

Ceylon being comparatively a small economic unit, the amount of the notes presented to the Commissioners at any one time was small. Since 1885, when the Government note issue commenced, the net amount of the notes returned to them did not, *in any single month*, exceed Rs. 64.58 lacs (about £430,000). This maximum was reached in April 1922, during the depression. Actually, however, on none of the occasions when large quantities of notes returned from circulation, did the amount of the securities sold in any one month exceed, apart from voluntary conversion of one class of securities into another, Rs. 37.50 lacs (book value). The normal seasonal contraction of currency, when such contraction took place, as before the Great War I, was on a very much smaller scale, being rarely above Rs. 20 lacs. That is to say, even under extreme conditions, relatively to the size of the market for the securities the amount of them, which the Commissioners had found themselves called upon to realize, in order to redeem the notes, was not considerable, so that, the Imperial Bank of India or the Crown Agents, as the case may be, were easily able to dispose of the securities without depressing the market or, barring exceptional cases, inflicting any loss, on balance, upon their principals.

VIII. *The Rate of Exchange*

On the question of the rates at which the Commissioners should convert Ceylon notes into either Indian exchange or sterling the law is silent. The Paper Currency Ordinance contemplated redemption of the notes into neither of them and consequently made no mention of any rate for such conversion. The amendment of 1901, which had permitted the issue of notes against sovereigns was not very clear on the question of the ratio between the rupee notes and sovereigns. It merely stated that notes should be issued 'in

exchange for the amount thereof in gold coin'. The 1917 amendment did not improve upon this position. It authorized the Commissioners to regard a 'credit at the Bank of England . . . as equivalent to a deposit of . . . gold coin' with them for purposes of currency issue. But, as the Indian rupee was the standard coin of the island, it was unnecessary expressly to state the sterling or the Indian exchange equivalent of Ceylon currency. The value of the latter in terms of sterling and Indian exchange was meant to be governed by the provision for its convertibility into rupee coins and for accounting purposes the Government always adopted, as a matter of course, the official par of exchange in India, whenever it had to deal in sterling.¹ Similarly, it valued rupee assets (or liabilities) at the par rate of one Ceylon rupee to one Indian rupee.

This left the Commissioners entirely free to negotiate a rate of their own while buying or selling sterling or rupee exchange within the limits determined by the mutual convertibility of the notes and rupee coins. The strength of their position in negotiating a rate most advantageous to themselves lay in the fact that they were obliged neither to accept, nor to surrender, sterling or Indian exchange in return for the notes. By threatening to deliver silver coins from their vault in Colombo, when notes were presented for conversion, and by refusing to accept sterling in London or rupee credits in Madras, when the banking system needed excess currency in Ceylon, the Commissioners could ensure that the best possible terms were offered to them. The banking system would always be willing to pay a small fee for the facility of getting funds in Colombo, at once, in exchange for sterling in London, as that would

¹ This was not done, however, simultaneously with the change in India. The new par was adopted in Ceylon, so as to avoid undue disturbance in the accounts, at the commencement of the following financial year.

save the banks the trouble and the delay of negotiating their transfer through India. Similarly, it would readily agree to pay a fractional premium in Ceylon currency, for the convenience of getting Indian or sterling exchange in redemption of the notes, rather than have to take delivery of rupee coins in Colombo.

That is to say, the Commissioners should be able to get from the banking system a fraction more of sterling than the prevailing buying rate of the exchange banks in Bombay, in return for the notes, issued in Colombo, and likewise sell sterling at a rate fractionally lower than the selling rate of the banks in Bombay. Similarly when buying or selling rupee exchange they could, if they insisted, successfully, levy a small commission. The maximum amount of the levy, however, is limited by the cost of shipping rupee coins from and to India or somewhat under $\frac{1}{2}$ d. per rupee or 25c. per cent.

But the advantage in the negotiation is not all on the side of the Commissioners. For, the exchange banks should be aware that the Commissioners are unwilling to be over-stocked with rupee coins and that, therefore, in practice they would not insist upon being paid in silver rupees for the notes, as they may then have to ship the coins to India and remit their equivalent from thence to the Crown Agents, if it was their policy to invest the funds in sterling securities. The bankers could not have failed to notice the preference of the Commissioners (until the outbreak of the present war) for investments in sterling of the currency assets since 1925, a bias which was further evidenced by the realization of rupee, rather than sterling, securities for redeeming notes since 1928. In other words payment in rupee coins could be as much a punishment to the Commissioners as to the banks, a circumstance which the bankers may have made full use of to screw down the rates as much as possible.

The position of the Commissioners is decidedly weak when it is a case of redeeming notes. With the coin reserve so dangerously close to the legal minimum the banks had not any great fear of being presented with silver rupees in return for the notes. When redemption in Indian exchange is more suitable to them, their bargaining power probably touches the minimum. The Commissioners do not maintain any standing balances in Indian currency to enable conversion of the notes in Indian exchange *at once*. Realization of securities must necessarily take time. Any hasty disposal of them might involve a loss. Moreover, the Commissioners have not the same facilities for raising temporary credits in India, as the Crown Agents can provide them with in London, either by the pledge of sterling securities with the banks or by borrowing from the Joint Colonial Fund, pending sale of the securities.

Which of these two opposing forces prevail in practice, however, can be known only to the contracting parties, as the rates at which the Commissioners buy or sell sterling or rupee exchange are not made public.

IX. *The Law of the Coin Reserve*

Whatever this may be, success of their policy of dealing in exchanges ultimately led the Commissioners to be sceptical of the utility of the coin reserve. After they discovered, for the first time in July 1920, the possibility of redeeming the notes in exchange, they changed their attitude towards the coin reserve (see TABLE XI on pp. 170-71 above and Appendix I). In the last quarter of 1920 it fell below the one-third ratio and remained in that position throughout 1921 and the first quarter of 1922. (But, probably, the failure of the Commissioners to redress the deficit ratio was partly owing to the embargo on the export of rupee coins from India, which was in force at the time.)

In April 1922, the deficit reserve was turned into a surplus, not through any augmentation of the coin in the vault but by a large contraction in the note circulation, which was almost wholly met by realizing securities. Thereafter a more or less free margin of the coin reserve remained until the close of December 1931. But the Commissioners resisted any tendency towards any unnecessary accretion of their coin holdings. They accepted payment in coins, for the notes they issued, only to the extent required in order to keep the ratio above the legal minimum.

This was, however, a very precarious situation. With the coin reserve hovering dangerously close to the minimum, any insistence, on the part of the holders of a large quantity of notes, to be paid in rupee coins, was bound to drive the ratio below the statutory minimum. This happened in October 1931, when Rs. 14 lacs worth of coins were taken out of the reserve against equivalent notes returned to the Commissioners. It at once turned the coin in the vault into a deficit of Rs. 1.87 lacs. Since then the position has remained un-rectified and the coin reserve has been more or less below the legal ratio.

If, however, in 1934 and later in 1937, 1939 and 1940, the Commissioners had insisted upon having only rupee coins before issuing notes and had not accepted sterling credits, instead, the coin reserve would have risen (except in the last case) well above the legal minimum. But having been none the worse for keeping the reserve below the prescribed proportion for several years, they were not too keen to add to the idle quantity of coins in their possession and thereby throw away the chances of earning a revenue of 3 per cent per annum, which represented the average interest fetched by the securities held by them. Consequently, with the increase in the note circulation the reserve proportion fell instead of rising.

But the official view¹ seems to be that section 17 of the Paper Currency Ordinance, which makes it incumbent upon the Commissioners to maintain a one-third coin reserve, remains suspended by Ordinance No. 1 of 1917 and that, therefore, the Commissioners are not obliged to maintain a one-third specie reserve. The validity of this contention, however, is seriously open to doubt. Section 17 of the original Paper Currency Ordinance runs as follows: 'If at any time the specie held by the Commissioners as mentioned in section 12 should be reduced below one-half of the notes in circulation, it shall not be necessary for the Commissioners (except by special direction of the Governor) to sell and realize any of the said securities, unless and until the amount of specie in their hands shall be less than one-third of the notes in circulation at the time. *Provided that no further investment in the said securities shall be made until the reserve mentioned in section 12 shall amount to one half at least of the amount of currency notes in circulation*'. That is to say, (1) the Commissioners of Currency need not, unless the Governor insists, dispose of securities in their possession to restore the reserve ratio to 50 per cent when the latter remained below this limit; (2) they are obliged to do so when the reserve ratio fell below one-third; and (3) they must not make any additions to their holdings of investment during periods when the rupee reserve remained below 50 per cent.

Section 5 of Ordinance No. 1 of 1917 added two riders to this section. Of these the first, with which we are

¹ Commenting upon the coin reserve ratio the *Report of the Auditor-General* for 1934-35 observes: 'The Currency Ordinance, No. 32 of 1884, requires that the coin reserve should not fall below one-third of the notes in circulation and that no further investments should be made until the coin reserve amounts to one-half at least of the notes in circulation. These requirements were suspended by section 5 of Ordinance 1 of 1917' (para. 444). The same formula is repeated in the *Report* for 1936-37.

immediately concerned, is as follows: 'Provided further that the operation of the above *proviso*¹ shall be suspended, and shall be deemed to have been suspended, as from the Thirtieth day of December, 1916, until such date as shall be notified by order of the Governor in the *Government Gazette*.' This rider suspended only the 'proviso' to section 17 of the original Ordinance, which I have given above in italics. It did not suspend the section in toto. That is to say, only item (3) of the terms of the section remains negatived and items (1) and (2) remain fully in force. In other words the amendment of 1917 did not absolve the currency authority from the obligation to maintain at all time a specie reserve of at least one-third.

¹ Italics are mine.

CHAPTER IX

THE (DRAFT) PAPER CURRENCY ORDINANCE, 1939

I. *The View of the Committee of Experts*

THE subject of currency reform had been engaging the attention of the Government since 1936. Subsequent to a preliminary correspondence between the Colonial Office, the Imperial Treasury, and the Government of Ceylon, the 'whole question of a change in the currency system was submitted in 1937 to an expert committee in London, which unanimously tendered the following advice:—

'(1) Ceylon should create a separate currency of her own on the basis of a Ceylon rupee. (2) The Ceylon rupee should be linked with the Indian legal tender rupee. (3) There should be an optional link with sterling. (4) In the unlikely event of devaluation of the Indian rupee, Ceylon should then decide whether to allow the Ceylon rupee to follow the Indian rupee or not. If not, the right to receive Ceylon rupees in exchange for Indian rupees should be withdrawn and the optional sterling link should become operative. But this means that the value of the Ceylon rupee could be maintained intact if the Ceylon Government considered that course desirable'.¹

The scheme of the experts was approved by the Secretary of State as well as by the Board of Ministers, and an Ordinance, generally based on the experts' report, was published in the *Government Gazette* dated August 4, 1939.

¹ Press *communiqué* issued by the Financial Secretary. *The Ceylon Daily News*, May 23, 1938.

'The scheme of the existing Ordinance for the regulation of the currency of the Island', declares the statement of objects and reasons attached to the Ordinance, 'is unsuited to modern conditions; further, it involves the maintenance of a considerable reserve in Indian silver rupees, which is uneconomic. The object of the bill¹ is to provide for the economic handling of the Island's currency on up-to-date lines'. It repeals the Paper Currency Ordinance of 1884 together with its amendments.

The bill entrusts the management of the currency to a Board of Commissioners of Currency. Unlike the present Board of Commissioners it will not be a body of Government officials merely. In addition to the Financial Secretary, the Deputy Chief Secretary, and the Deputy Financial Secretary, who constitute the Board today, two Commissioners will be nominated to it by the Governor after consultation with the Board of Ministers. The nominated Commissioners shall hold office for three years. Their presence on the Board, however, would not destroy official control of the currency and exchange policy of the Island. For, the Financial Secretary is the chairman and the chief executive authority of the Board and the three officials on the Board can function as the Board if both nominated members remained absent. Also the Board shall meet only 'when-ever convened by the Chairman'.

II. *The Ceylon Rupee*

The bill creates a new unit of value called the Ceylon rupee, the physical embodiment of which will take the form of the currency notes issued by the Board of Commissioners of Currency. Like the currency notes of today they will

¹ It follows more or less closely the Straits Settlements Currency Ordinance No. 23 of 1938.

be issued 'in the name of the Government of Ceylon' and will be unlimited legal tender. Fractional coins, which will be issued by the Board, and not by the Treasury as hitherto, will be legal tender up to a limit of Rs. 5 in the case of silver and Re. 1 in the case of nickel and copper.

As the creation of a new monetary unit of value renders the old status of the Indian rupee coin untenable, the Ordinance provides that the coin shall cease to be legal tender. Its demonetization ensures that the difficulties which entailed the abnormal rise in the price of silver during the latter part of the Great War I, shall not recur. As a safeguard against the same contingency, the Ordinance also provides that the weight and fineness of the subsidiary coins can be altered by the Governor, with the previous approval of the Secretary of State, by Proclamation published in the *Gazette*.

The creation of a new standard of value and the demonetization of the rupee, however, are more a nominal, than a real, change. The silver rupee has long disappeared from circulation. And, notwithstanding the Indian coin having been the ultimate standard unit of the Island, Ceylon currency has always been separate from the Indian system even as the South African and Australian currencies before the Great War I were separate from the British system, notwithstanding the sovereign, into which the bank notes in the two countries were convertible, having been unlimited legal tender. So long as the nominal parity between the Ceylon and Indian currencies is continued the difference between the new and the old systems will hardly be perceptible. It will be apparent only if Ceylon were to choose a different parity from the present one with the Indian rupee.

The new monetary unit will be linked to the Indian legal tender through the sale and purchase of Indian

exchange, at rates based upon a par of exchange (section 14). The Board of Commissioners of Currency shall pay 'Indian currency at Bombay to any person who shall pay or cause to be paid to the Board in Colombo the equivalent value in Ceylon currency, of the Indian currency required'. Similarly, the Board shall 'issue Ceylon currency in Colombo to any person who shall pay or cause to be paid to the Reserve Bank at Bombay the equivalent value in Indian currency of the Ceylon currency required'.

III. *The Optional Link with Sterling*

But the Government 'may with the concurrence of the Board of Ministers by order in writing suspend the obligation to issue Ceylon currency in exchange for Indian currency'. Thereupon the 'Ceylon currency shall be linked to sterling (section 15). The Board shall then 'pay sterling in London', on demand, in exchange for equivalent value in Ceylon currency for the sterling required, paid to the Board in Colombo. Likewise, it shall issue Ceylon Currency in Colombo in exchange for sterling deposited with the Crown Agents in London. In order not to compete with the banks in the sale or purchase of exchange, and also to save it the embarrassment of having to deal in small amounts, the 'Board shall not exchange currency as herein-before provided unless the amount of the Ceylon currency to be given or received in exchange is not less than the prescribed minimum sum' (section 16). The minimum shall be prescribed by the Board at its discretion. Under the old Ordinance, the purchase or sale of rupee coins was not subject to any similar limit.

This provision for an optional link with sterling, it will be noted, was based upon the recommendation of the committee of experts in London. In explanation of this recommendation of the committee, the Financial Secretary

observed in the press *communiqué*¹ that it was meant to 'decide whether to follow the Indian rupee or not' in the possible event of the Indian currency authority deciding to devalue the Indian rupee. 'An unqualified link with India', continued the *communiqué*, 'would leave Ceylon in her present position, in which she is bound by the currency policy of India. There is an influential body of opinion in India which holds that 1s. 6d. is too high a value for the Indian rupee, and that its value should be reduced. There is no reason to suppose that any such change is in prospect; but the fact remains that if India should devalue her rupee she would do so by reference to considerations affecting India and at a time to suit herself, and that those considerations and that time might be by no means applicable or advantageous to Ceylon. Any change in Ceylon currency arrangements should, therefore, provide for the possibility of the Ceylon Government pursuing its own currency policy'. If the Ceylon Government thereupon were to decide not to follow the Indian rupee 'the right to receive Ceylon rupees in exchange for Indian rupees should be withdrawn and the optional sterling link should become operative'.

In view of the extensive economic relations of the Island with India, however, the provision for an optional link with sterling would seem to be of doubtful practical advantage. Tea, which is the mainstay of the Island, and coconut, which is an important source of income to the indigenous population, both have India for their chief rival. Indian tea competes with Ceylon tea in the world market, and Ceylon copra and other coconut products have to compete with the Indian produce in the Indian, or foreign, markets. The importance of the two industries in the economy of the Island is revealed by the following table which gives

¹ Op. cit.

figures of the value of their exports and their proportion to the total exports of Ceylon produce for the past several years :—

TABLE XIII

EXPORTS OF TEA AND COCONUT PRODUCTS

Source : *Reports of the Principal Collector of Customs*

(Rs. 1,000,000)

	A	B	C	D	E
Year	Tea	Coconut products ¹	A + B	Total exports of Ceylon produce	Percentage of C to D
1930	181·97	46·78	228·75	291·38	78·50
1931	138·66	36·30	174·96	207·54	84·32
1932	107·66	35·05	142·71	166·46	85·71
1933	117·88	28·95	146·83	179·44	81·85
1934	145·03	28·98	174·01	240·40	72·38
1935	145·72	36·04	181·76	229·60	79·16
1936	153·34	33·55	186·89	243·85	76·63
1937	170·52	48·46	218·98	309·31	70·80
1938	172·35	34·49	206·84	262·82	78·71
1939	188·03	35·60	223·63	304·16	73·51

From the table we see that, except in 1934, 1937 and 1939, tea and coconut products comprised over 75 per cent of the Ceylon produce exported. If, therefore, Ceylon were to fail to fall in line, in the event of India devaluing her currency, Indian tea as well as copra and other coconut products will enjoy an exchange bounty, in relation to

¹ Includes poonac; fresh coconut; desiccated coconut; arrack; bristle and mattress fibre; copra; oil; coconut shell charcoal; coir-yarn; mats; matting; and rope.

Ceylon produce, by the margin of the devaluation. This would correspondingly diminish the competitive strength of the Ceylon tea and coconut plantations. The policy of encouraging the domestic production of rice and agriculture generally, will find the task more difficult than at present, through Indian imports of grain and other articles of food becoming cheaper. Despite the consequences of it to the major industries of the Island, if the currency authority were to persist in maintaining the higher ratio, the possible drain on the currency reserve, which must follow a worsening of the adverse trade balance with India, might force the Island off the ratio and thereby indirectly bring about a downward adjustment of it.

A ratio lower than the Indian ratio is also of doubtful value. It might raise the price of rice and other articles of food for which Ceylon depends upon India. Through the effect of this on the cost of living of the working population it might lead to increased production costs in the Island. Indian workers, who man the plantations, being accustomed to the mutual convertibility of the Indian and Ceylon rupees practically at par, might demand a higher wage rate to compensate for the loss on exchange. The combined effect of these forces might neutralize such advantages as the Island's export industries might derive through the lower ratio. There is also the danger of the Indian coconut interests, which are unable to withstand the competition of Ceylon copra and clamour for protection even in normal times, raising the cry of 'exchange dumping' by Ceylon. If the Government of India were to respond to what might then appear a legitimate grievance, and raise an exchange depreciation tariff, the supposed gain to the coconut industry from the lower ratio might altogether disappear. Indeed, on balance, it may even turn out to be a loss, if the lower ratio were to raise wages and the cost of production.

It would seem, therefore, that, the interests of Ceylon would be best served by following the exchange policy of her big neighbour. Countries similarly placed have found it advantageous to do so. Ireland, the dependence of whose agricultural produce upon the British market has always been a cardinal feature of her economy, has habitually formed practically an integral part of the British currency area, more or less in the same way as Ceylon has formed a part of the Indian currency area. The report of the Irish Banking Commission, 1938, after a careful examination of the question, urged upon the Free State Government the inadvisability of disturbing the prevailing parity relation of the Irish currency with the pound sterling. The Scandinavian countries, in view of the importance of the British market for their produce, followed sterling, rather than gold or any other currency, subsequent to the departure of the pound from the gold standard in September 1931.

In the case of Ceylon, the facts of geography¹ and commerce, no less than the evidence of history, are against pursuing a different course. We have seen that since the very early times Ceylon has used more or less the same currency unit as the mainland of India. The Portuguese, probably, never seriously attempted fundamentally to change the prevailing currency order of the Island. During their rule, they left the trend of its development, which followed the trend on the Coromandel Coast, practically undisturbed. Under the Dutch the Island never permanently gave up the use of the *fanams* and *pagodas*. Debasement and inflation, during the time they lasted, no doubt, obliterated the connection of the Ceylon system with the Indian. But, with the restoration of normal conditions, Indian money returned into the Island and soon re-established its customary place

¹ The Island is removed from the mainland of India by 22 miles, which takes the ferry boat of the South Indian Railway about 2 hours to cross over, and by air the Island is separated from India by about 10 minutes.

in the circulation. The determined effort made in 1825 by the Imperial Treasury to claim the Island into the sterling area merely had the effect of making the position of the Indian rupee stronger than ever.

So long as India does not devalue her currency, however, Ceylon currency will remain linked to the Indian legal tender. This puts an end to the present uncertain position. Since the adoption, in practice, of the exchange standard system, the Ceylon currency standard has been a sort of a graft between a sterling exchange standard and a rupee exchange standard, the exact nature of the standard depending upon the exigencies of the situation. The Currency Commissioners bought, sometimes sterling exchange and sometimes rupee exchange. Similarly, the notes were redeemed sometimes in the one and sometimes in the other.¹

IV. *The Distance between the Exchange Points of the Ceylon Rupee*

The par of exchange, under the new Ordinance, between the Ceylon and Indian currencies shall be, as at present, one Ceylon rupee to one Indian rupee. But the Board shall be entitled to levy a small charge for the mutual convertibility of the two currencies, which, it shall 'prescribe from time to time' but subject to a maximum of 'one rupee and seventy-five cents for every one hundred rupees of Ceylon currency taken or given in exchange.' If telegraphic transfers are demanded, 'a charge for all telegraphic communications between the Board and its agents in connection with the exchange calculated at the usual rates prescribed for the public' shall be levied, in addition to the usual commission for telegraphic transfers (section 17). These provisions apply to the link with the Indian legal tender as well as to the optional link with sterling.

¹ See Table VIII on p. 158 above and Table XII on p. 172 above.

In fixing the maximum amount of the levy the framers of the Ordinance seem to have had three chief considerations before their mind. (1) It must cover the requirements of the link with the Indian legal tender as well as of the optional link with sterling. (2) The terms for the sale or purchase of sterling must be such that they do not permit of being, in any way, more advantageous than the prevailing sterling rate in India. Otherwise exchange operations arising out of India's trade with foreign countries, which must properly be the concern of the Indian exchange market, and not that of the Ceylon Currency Board, might be diverted to Ceylon. (3) At the same time the rates must not be so wide as to allow any possibility of an inflationary issue of currency, which might defeat the purpose of currency and exchange regulation.

The maximum commission leviable under a sterling exchange standard (assuming orthodox principles governing their determination) must obviously be larger than what may be applicable under a link with the Indian legal tender. For, otherwise the buying and the selling rates for sterling would be vastly more advantageous than the corresponding statutory rates of the Reserve Bank of India. Assuming the limits of the levy to be 25c. per cent under the rupee exchange standard, if the rates for the mutual conversion of the Ceylon and British currencies were to be no larger, the buying and the selling rates for sterling would be 18 $\frac{1}{2}$ d. and 17 $\frac{1}{2}$ d., respectively, per Ceylon rupee, which would contrast with a buying rate of 18 $\frac{3}{4}$ d. and a selling rate of 17 $\frac{1}{4}$ d. of the Reserve Bank of India. There is then the danger of Ceylon being drained of her sterling reserve whenever the Indian exchange became more adverse than the Ceylon selling rate and, conversely, of being flooded with sterling whenever the Indian exchange was higher than the Ceylon buying rate.

This danger, however, is possible only if the statutory

par between the Ceylon and Indian rupees remains undisturbed and the two currencies are interchangeable at the usual commission, whilst, at the same time, the Ceylon rupee is linked to sterling at the above rates. Such a contingency might arise if, anticipating a devaluation of the Indian monetary unit, Ceylon should decide to avail of the optional link with sterling. Under these conditions, until the devaluation actually takes place, there is the possibility of Ceylon being called upon to supply the Indian demand for sterling, which might possibly jeopardize her ability to pursue an independent exchange policy.

In order to guard against this danger, it is necessary that the maximum rate of the commission must not be less than the commission leviable under the Reserve Bank of India Act plus whatever commission the banks may charge for the mutual conversion of the Ceylon and Indian rupees. Of these two magnitudes we know the former and have an idea of the latter. At the price of 17½d. per rupee, the commission which one must pay to the Reserve Bank of India for every Rs. 100 worth of sterling (£7.10s.)¹ would be Rs. 1.32.² To this the framers of the Ordinance have added 43c., which must be compared with a maximum commission, very rarely reached in practice, of 25c. per cent under the present system. That is to say, the commission which the Currency Board is entitled to levy for the sale of sterling can be 18c. per cent worse than the expense, to the holders of Indian currency, of procuring sterling from the Reserve Bank at the latter's statutory selling price. This will effectively protect the Board from any Indian run on its sterling reserve and would thereby enable it to

¹ Calculated at the par rate of 18d. per rupee.

² The commission for Re. 1 worth of sterling, namely 18d., would be the equivalent in rupees of ¾d., which, at the price of 17½d. per Re. 1, is Re. 0.0132 (approximately) i.e. the commission for every Rs. 100 worth of sterling would be Rs. 1.32.

formulate undisturbed a currency and exchange policy of its own. It will be noted that, unlike the Reserve Bank of India Act, the Ordinance does not prescribe separate commissions, one for the conversion of sterling into rupees and the other for the conversion of rupees into sterling. In both cases it would be Rs. 1.75 per cent.

Whatever may be the explanation of the maximum amount of the levy, it is out of all proportion to the needs of a rupee exchange standard. No doubt, in practice, the Board may quote rates within limits which may not be far different from the existing limits and actually the position might then be more or less the same as at present. Nevertheless, the Ordinance introduces an element of doubt that it will do so, which might make the system function with undesirable, rather than beneficial, consequences.

In theory, it makes the distance between the upper- and the lower-exchange points of the Ceylon rupee relatively to the Indian rupee, as much as 3.5 per cent, which contrasts with a distance of 0.5 per cent, under the present system. Between no two pairs of countries so close to one another is this distance so high. The gold points between France and Great Britain have a range of only 0.5¹ per cent reckoning interest at 5 per cent. The range between London and Amsterdam is about 0.8 per cent, between London and Berlin about 0.7 per cent, and between London and New York about 0.76 per cent, in each case reckoning interest at 5 per cent.²

V. *The Theory of the Distance between Exchange Points*

The degree of separation of the gold points under a direct gold standard and the exchange points under an exchange standard, is a vital factor in the problem of

¹ Paul Einzig, *International Gold Movements*, London, 1931, Appendix I.

² Ibid.

managing a country's currency and, as is now widely recognised, ought to receive very careful attention. Its effect on the economy, through the influence on the mobility of the short-loan fund as between the home, and foreign markets and, therefore, on the domestic money rates of interest is far reaching. Nevertheless, as has been forcibly pointed out by Mr. J. M. Keynes, decision on the subject has not always been the result of sufficient care and deliberation.¹ It seems worthwhile, therefore, digressing for space to review in broad outline certain points with regard to the theory and practice on this subject.

Under exchange standards, the exchange points have been determined not with reference to the wider question of their influence on the economy generally, but chiefly with the object of ensuring that the system will function, at any rate in so far as the two currencies linked to one another are concerned, more or less in the same way as a direct gold standard. Thus, under the Indian Currency Act, 1927, the upper- and the lower-exchange points of the rupee were to be determined from time to time with reference to the cost of 'transferring gold bullion in bulk from Bombay to London, including interest on its value during transit' [section 5 (2)] and the rates so determined were to be notified in the *Gazette of India*. Thereby it was thought that

¹ In most cases, the spread between the gold points 'has been governed by influences some of them historical and some of them purely fortuitous'. In the case of Great Britain, for instance, one of the elements in this spread, namely, the difference between the rate at which the Bank of England gave notes for gold (£3-17-9 per standard ounce) and the rate at which it gave gold for notes (£3-17-10½ per standard ounce) is a historical survival. It was based upon the convenience and economy of getting notes for gold bullion *at once* instead of taking the bullion to the mint and waiting for it to be turned into sovereigns. Common usage led to the adoption of it in the currency law of the country, first in the Bank Charter Act of 1844 and later in the Gold Standard Act of 1925. For a very instructive discussion of the subject see J. M. Keynes, *Treatise on Money*, Vol. II, London, 1930, pp. 319ff.

the 'sterling points' of the rupee would coincide with its 'gold points' as between Bombay and London and that the rate of exchange between the rupee and sterling would consequently behave as if the rupee also were directly linked to gold.

The Reserve Bank of India Act, instead of making the two points the subject of determination from time to time, fixed them once for all at 18 $\frac{3}{4}$ d. and 17 $\frac{1}{4}$ d., which roughly approximated to the gold points of the rupee in relation to Great Britain. The upper point of the Reserve Bank Act being above par by a smaller margin than the lower point is below it, however, did not imply that the cost of shipping gold to Bombay from London was less than the cost of shipping it in the opposite direction. Historically it was the result of a policy which was designed to prevent any disturbance in the working of the exchange standard by un-necessary inflow of sovereigns into the country. In order to serve this end it was considered expedient to place the upper sterling point of the rupee fractionally below the cost of importing sovereigns from London. After the demonetization of the sovereign the device was still useful in preventing un-necessary and burdensome movements of gold bullion, and, therefore, was allowed to remain.

From the viewpoint of the mechanics of the gold exchange standard, however, it is not necessary that there must be any difference in the monetary authority's buying and selling price of exchange. The presence or absence of the difference, that is to say, is immaterial for purposes of effecting the link of one currency to another. But, probably, the mechanics of the standard demands that the distance between the exchange points, if for any reason it was decided to have some difference between them, must not be greater than the distance between the gold points, especially when gold coins, as in India before the Great War I, passed into

circulation and were legal tender. It would then be cheaper to make, and receive, external payments in gold coins or gold bullion and, in practice, the exchange standard might not operate at all. It might prove to be either a gold currency standard or a gold bullion standard as the case may be. But there is nothing to prevent the statutory exchange rates from falling within the gold points or being identical.

In recent years, however, a theoretical case has been made out in support of keeping a fairly wide margin of difference between the gold points. Mr. J. M. Keynes, the chief exponent of this view, for instance, has suggested that 'the difference between a Central Bank's obligatory buying and selling prices of gold should be made somewhat greater than hitherto say 2 per cent, so that there would be at least this difference between the gold points irrespective of the actual costs of transporting gold (double the amount of which would have to be added on to the 2 per cent to give the difference between the gold points). But a Central Bank would be free at any time, if it wished to encourage the movement of gold inwards or outwards, to quote closer prices within the legal limits¹'.

The object of the reform is to serve as one of the twin devices of managing a country's currency so as to enable a 'Central Bank to protect the credit structure of its own country from the repercussions of purely temporary disturbances abroad, whilst the laws of long-period equilibrium would remain as before'.² The other device is to 'control when necessary, within the limits set by the gold points and the relative rates of interest at home and abroad, the premium or discount of the forward exchange on the spot exchange'.³

¹ *Treatise on Money*, Vol. II, p. 325.

² *Ibid.*, p. 236.

³ *Ibid.*

There are, however, important practical limitations to this reform proving an effective, or lasting, solution of the problem.¹ These apart, the metaphysical arguments advanced in support of it cannot properly be adduced in justification of the wide range which separates the exchange points of the Ceylon rupee under the new Ordinance. For, the remedy was designed chiefly for creditor countries, which harboured foreign short-term money or had large balances of their own which could be temporarily attracted abroad. Probably, Mr. Keynes had in mind, primarily, the problem of segregating the international deposit banking business of the City of London, and the means of controlling it, from the domestic business arising out of trade and industry, with a view to acquire the maximum possible stability in the latter. But it seems to be out of place to apply the formula to *overwhelmingly* debtor countries like Ceylon. In their case there usually exist several barriers which virtually shut them off to all free traffic in short-term money, to make it necessary to raise any protective wind-screens against their undesirable effects.

In the first place debtor countries, being unable to maintain a *free* gold standard, are usually on a gold exchange standard or adopt the gold exchange standard device in practice in order to keep the value of their currency stable. Under exchange standards the limits of fluctuation of the exchanges with the outside world, except with the country with which the link is maintained, are wider than under a direct gold standard. For example, the distance between the exchange points of the Indian rupee, under a sterling exchange standard, with countries other than Great Britain, assuming sterling to be on gold, would be made up of the distance between the gold points of Great Britain with the country concerned plus the distance between the sterling

¹ See B. R. Shenoy, 'The essentials of a Gold Standard', *Journal of the Indian Institute of Bankers*, April 1933, pp. 11ff.

exchange points of the rupee, which would be clearly larger than the distance between the gold points of the rupee with the same country, if the rupee were directly linked to gold. This would have the effect of virtually disconnecting the credit system of the exchange standard countries from the money markets abroad except that of the country to which the exchange standard currency is linked. There need be little fear, therefore, of exchange standard countries being embarrassed by the presence of large quantities of fugitive foreign balances.

Secondly, their financial and money market organizations are not, generally, sufficiently well developed to encourage foreign liquid funds to seek investment in them. Hardly any of them own an open bill market where first class bills of an international status are plentiful and could be freely negotiated. The readily available instruments in which the funds might be invested are not generally of the finest quality from the standpoint of international finance, so that the money markets of debtor countries offer but little temptation to liquid funds from abroad which wish to retain a high degree of liquidity.

Thirdly, their extreme debtor position would always act as an obstacle to *temporary* surplus funds taking refuge in them, however attractive the rates of interest may be. For, the danger of a withdrawal of the funds involving a considerable loss through a weakening of the exchange as the consequence of a change in the terms of trade or of foreign long-term capital leaving the country is never too remote. Moreover, the chances of panic leading to a quick application of devices such as moratoriums, or exchange control, whereby the funds would get 'frozen', are greater in the case of debtor countries, as their inherent power of resistance is more negative than positive.

In the case of Ceylon all the three barriers have always been present in an eminent degree and consequently,

short-term capital from abroad has never been able or too anxious to seek investment here freely and voluntarily. Perhaps hardly any 'hot money' ever found its way into Ceylon. Such capital as did come was mostly from the London money market, which seems significant in view of the above analysis, and was brought in by the British exchange banks, which enjoyed a monopoly of the trade. As noted elsewhere, they attracted deposits, chiefly fixed deposits subject to a period of notice before withdrawal, through their London offices by offering tempting interest rates. Nor is there any danger of the domestic funds seeking investment abroad on any large scale. For, the rate of interest available here is appreciably more than what could be had in foreign centres. They would leave the country only in times of grave panic caused by fears of depreciation, which no device of flexible parities can possibly stem, as a rise in the selling price of exchange by a margin permissible under the statutory distance between the exchange points can be no deterrent to their movement on such occasions.

Thus, the remedy designed to secure domestic stability in the case of Great Britain and other countries, similarly placed, is superfluous in the case of Ceylon. On the contrary, its adoption might possibly have just the opposite effect. The Island depends to a large extent upon foreign sources for its long- as well as short-term capital requirements. Its banking system depends for emergency credit chiefly on India. While the reform might leave unaffected the flow of long-term capital it might affect unfavourably the movement of short-term capital and, therefore, the short-term rates of interest. The access to the Indian money market might be less free and the disparity between the Ceylon and Indian money rates might be larger than at present. That is to say, the new Ordinance, instead of improving the present position by removing the existing barriers in

order to render the flow of funds less tardy, which seems to be the real problem facing the Island's credit system, makes it potentially worse. For having to bear the possible additional risk which would involve the importation of funds from India, the banks may think it proper to charge higher rates of interest to their customers.

VI. *The Irish Model for Ceylon*

It would seem, therefore, that the needs of the situation would be better met by providing for the purchase and sale of Indian exchange *al par*. As the cost of remittance of funds between India and Ceylon would then be nil, this would ensure identity of interest rates in the two countries in place of the present difference of 2, or more than 2, per cent. The advantages of it to the Island's economy through reduced cost of credit would be considerable. Moreover, the system would bring with it the benefits of a direct link with sterling, namely, exchange stability with the outside world. The interchangeability of the Ceylon and Indian rupees being at par, the limits of fluctuation of the Ceylon rupee, in terms of sterling, would then be identical with the sterling points of the Indian rupee. Sterling quotations in Colombo would be on a par with sterling quotations in Bombay, even as the quotations in Calcutta and Madras are on a par with the latter.

This version of the link is followed, in practice, under the present system. Whenever the Commissioners have accepted or given out Indian exchange, for issuing or redeeming currency notes, they have done so at par. The suggested reform would, then, only seek to enforce in law what is already in force, in fact.

It has a precedent in the traditional currency arrangement of Ireland, the economic and the financial relationship

of which with Great Britain resembles in several respects that of Ceylon with India. The Irish pound is convertible into the English pound at the nominal par i.e. at the rate £1 English for £1 Irish. This relationship has remained unbroken since 1825, when the Irish currency ceased to have a separate existence. The principle as well as the terms of the link with the British currency were approved by the Banking Commission, 1926, and were adopted in the Currency Act of 1927.¹ Though the Act rechristened the Irish monetary unit as the Saorstat pound and provided for the issue of a Saorstat gold coin of the same weight and fineness as the sovereign, the old arrangement continued practically without alteration.

The question of the Free State monetary standard was once more examined by the Commission on Banking, Currency, and Credit, 1938. The Commission was decidedly of the opinion that in view of the interpenetration of the Irish economic and banking systems with those of Great Britain, the Free State could not possibly, without detriment to her own interests, either abandon the link with sterling or choose another sterling parity. The following argument of the Commission in support of its view is well worth quoting in full, as it is applicable in a remarkable degree to the Ceylon situation. In the absence of a link with sterling, argued the Commission, 'a "foreign exchange" market in sterling would have to be created by the banks—the cost of which would have to be borne by the Free State economy in the shape of a margin between the buying and selling prices for sterling.'² Moreover, unless the monetary authority were to be obliged to hold only gold as a reserve against note-issues, it is difficult to avoid the

¹ For details see *Legislation on Gold*, League of Nations, 1930, pp. 261-65.

² Italics are mine.

conclusion that it would be forced to continue to hold a certain proportion of sterling assets, since—apart from the possible case of dollar securities—only in London is it possible to acquire securities of the kind appropriate with the certainty that they can always be disposed of in a highly liquid and efficient market. Time differences alone would make New York an awkward market to deal in from the standpoint of the monetary authority. Moreover, dealings in gold would as a rule still have to be made in the London market, so that, here again, the absence of a formal link by no means disposes of the real “sterling risk”.¹ In other words the Commission believed that a sterling exchange standard was the natural standard for the Free State. The Commission was also opposed to any alteration in the terms of the link with sterling.

By virtue of the identity in the buying and the selling rates of exchange, interest rates in Ireland have always followed the low level of the rates ruling in London; and the Irish economy has enjoyed comparative stability of money conditions, which London, through its vast resources and a highly efficient credit system, has been able to command over long periods. The Free State has shared, without having been called upon to pay for it, the benefits of the British Exchange Equalization Account and the protection which it has afforded from undue exchange fluctuations due to transitory causes unrelated to the structure of the internal economy.

These advantages would not have accrued to the Free State economy in identically the same measure as to the British economy, if the rates of conversion between the two currencies were subject to the levy of a commission. The measure of the advantages would then necessarily

¹ *Report*, pp. 132-33.

have been *one degree removed, depending upon the amount of the commission*. It would have meant comparatively higher interest rates, fluctuating exchange with Great Britain though within limits, and lesser benefits of the activities of the Exchange Equalization Account in smoothing out undue deviations in the value of sterling.

VII. *The Security Fund*

To return to the Currency Ordinance, its reserve provisions are in several important respects different from the reserve provisions of the old Ordinance. The issue liabilities of the Board, which are to be covered by a Security Fund, will comprise (a) currency notes in circulation and (b) subsidiary silver estimated by the Board to be in circulation. The old Ordinance took no account of the latter and no specific reserve was held against them. But, being tokens like the currency notes, it seems but logical that provision should be made for their redemption as well. The amount of the reserve to be held against them, however, need not be 100 per cent as, unlike paper money, they have an intrinsic value measured by the value of the metal they contain. The Ordinance, therefore, while prescribing that the liability of the Board shall comprise notes as well as coin tokens (section 33) includes, as we shall see presently, in the assets to be held against this aggregate liability, the realizable value of the silver in the estimated amount of the coin in circulation (section 31), so that the actual reserve backing held against the latter would represent only the uncovered portion of the face value of the tokens.

The Security Fund, into which will be paid the currency reserve maintained under the old Ordinance, less the excess over the note and coin liability, which will go to the general revenue (section 20) will comprise, (a) 'liquid moneys',

(b) the security investments valued at their market price less the amount of any advances obtained against their pledge from the Reserve Bank of India or the Crown Agents, (c) the realizable value of the silver held by the Board and (d) the realizable value of (i) the silver coins in circulation and (ii) the silver coins held by the Board. The Fund will be distributed between the Reserve Bank of India, Bombay, and the Crown Agents, London, in amounts to be determined from time to time by the Board. The Board may hold in Colombo only that portion of the Fund referred to in (c) and (d) (ii) above which, after the demonetization of the Indian rupee coins, would be chiefly Ceylon subsidiary silver (sections 23 and 31).

This distribution of the reserve, it will be noted, is in harmony with the redemption provisions of the Ordinance. As the Ceylon rupee notes will be redeemed in drafts on the Reserve Bank (or on the Crown Agents if, and when, the optional sterling link comes into operation) and will be issued in exchange for deposits with the Reserve Bank (or the Crown Agents in the same contingency as the above), it would be pointless to keep the main body of the reserve in Ceylon. Deposits received in exchange for Ceylon currency are best collected, and kept, in the centres where they have to be invested and where they will be needed to meet the drafts issued in return for the notes. Subsidiary silver coins, however, must lie in Colombo to meet any demand which may arise for them.

VIII. *The Liquidity Ratio*

The 'liquid moneys' of the Fund would comprise cash or deposits held in London or Bombay, moneys lent at call or short-notice in the two centres, or 'readily realizable securities' which will include, besides the Indian and

British Treasury bills and other short-dated obligations of the two Governments, probably, also high class bills of exchange. The remaining portion of the Security Fund shall be invested in securities of the Government of any part of the British Dominions other than the Government of Ceylon, in securities guaranteed by the Government of any part of the British Dominions other than the Government of Ceylon, or in any other securities approved by the Secretary of State [section 23 (5)].

The allocation of the reserve as between the two categories, namely, 'liquid moneys' and long-dated investments is left to the discretion of the Board, which may determine it with the prior approval of the Governor. When the liquid portion of the Fund falls below the ratio thus determined the 'Board shall *as soon as conveniently may be*¹ direct either the Crown Agents or the Reserve Bank or both to sell securities forming part of the Security Fund in order to restore the liquid part of the Fund to the said proportion' [section 23 (3)]. The Board may also, from time to time, with the prior approval of the Governor, alter the proportion of the liquid portion of the Fund. Furthermore, whenever the amount of the liquid portion is insufficient for redemption of the notes the Board may raise temporary loans from the Crown Agents or the Reserve Bank, as the case may be, on the pledge of the securities in the reserve. But the sums so borrowed must be repaid within a period of one year (section 24). The rigidity of the cash ratio—it will be noted that, under the new Ordinance, it is no longer the cash ratio but the liquidity ratio of which cash is only one of several items—has thus been done away with.

Past experience of the working of the Ceylon system,

¹ The words, which I have given in italics, are significant. They contrast with the rigour which surrounded the cash reserve provision of the old Ordinance.

theoretical opinion on the subject,¹ as well as opinion of the leading central bankers and practical financiers, seem to support the proposed change and it conforms to the modern tendency. The World Monetary and Economic Conference held in London in 1933 resolved that in order to improve the working of the future international currency standard 'greater elasticity should be given to Central Bank legal cover provisions' so as to 'increase the free reserve . . . and thereby to strengthen their position'. The conference suggested that a 'minimum ratio of not more than twenty-five per cent should be considered as sufficient'.² Steps on these lines had already been taken in some countries before the conference met and several others adopted its recommendations thereafter.³ It will be noted that the Ceylon Ordinance goes a step further: it fixes no statutory minimum but leaves it to the discretion of the currency authority to determine it from time to time. The reserve provisions of the Ordinance place Ceylon in the forefront of currency reform.

The old Ordinance had proved more a hindrance than a help to the Commissioners in the efficient discharge of their duties and responsibilities. It locked away and rendered useless, for practical purposes, the greatest part of the coin reserve. How large a proportion of it was

¹ For a theoretical discussion of the subject see Keynes' *Treatise on Money*, Vol. II, pp. 262ff. •

² Resolution III (2).

³ The legal minimum reserve ratio was reduced in Austria in 1932, Poland, Sweden and Denmark in 1933, Czecho-Slovakia and Hungary in 1934, the Free State of Danzig in 1935, and Bulgaria and Latvia in 1936. In most of them the new minimum reserve was fixed at 25 per cent, or below, of the note, and demand, liabilities. The minimum reserve of the central bank of the Argentine founded in 1935 is 25 per cent. See the *Fifth Annual Report of the Bank for International Settlements*, p. 50; the *Sixth Annual Report*, pp. 56 and 61; and the *Seventh Annual Report*, p. 96.

sterilized by belonging to the legal minimum reserve is shown by the following table :—

TABLE XIV

Source : Monthly Statements of the Commissioners of Currency

(Rs. 100,000)

	A	B	C
Date of Return	Legal minimum coin reserve	Excess reserve	Percentage of B to A
December 31, 1925	193·24	32·20	16·67
" 1926	209·15	44·03	21·05
" 1927	208·24	42·20	20·27
" 1928	191·39	33·50	17·50
" 1929	190·97	32·68	17·11
" 1930	190·70	32·13	16·85
September 30, 1931 ¹	141·47	1·17	0·83

Before the Great War I the position was worse in as much as the coin reserve was more frequently below the minimum of 50 per cent than above it and the Commissioners had to look on helplessly, year after year, in face of the seasonal demand for currency, which had consequently to be met by the community itself through the tardy method of importing rupee coins from India. The Ordinance had proved fatal to the principle of elasticity of the currency issue and had made the system function as a fixed fiduciary system in fact. Their inflexibility had caused a great deal of avoidable hardship during the latter part of the war as well as the immediate post-war period. The utility of the coin reserve for redemption purposes was negligible as it could not be touched after it reached the statutory mini-

¹ After this date the coin reserve fell short of the legal minimum.

mum without infringing the law. The presence of the legal reserve, that is to say, did not enhance the ability of the currency authority to defend the exchange value of the currency. Since the war this had to be done by realizing interest earning securities.

The Ceylon experience upholds the view that the level at which the cash reserve must be maintained, for purely psychological reasons, to promote confidence in the currency of the country, is capable of being easily exaggerated, since public opinion seems to be always content with what it gets habituated to. The alteration of the legal minimum reserve from 50 per cent before 1917 to 33 $\frac{1}{3}$ per cent after it and, in recent years, its fall below the latter proportion, did not cause any loss of confidence in Ceylon currency, either on the part of the public in Ceylon or on the part of the public abroad who had commercial and financial dealings with the Island. Public confidence would seem to be guided more by *the free margin of the reserve and its relation to the balance of payments position* rather than by *the absolute level of the legal minimum*.

IX. *The Theory of the Reserve Ratio*

Theoretically, as pointed out by Mr. Keynes, the chief object of the cash reserve is twofold: (i) to serve as a 'war chest' on occasions of precipitate changes in the balance of international indebtedness, and (ii) to act as a contingency fund in order to make up for any passing deficiencies in the foreign balance. The first portion of it must be large enough to cover the adverse balance until steps are taken to bring about fundamental adjustments in the economy so as to influence the trade balance in the required direction or until the self-adjusting forces in the economy had had time to operate. The second portion is meant to serve the purposes of seasonal or other temporary outward movements of funds which will soon be reversed, and

which, consequently, need no adjustments in the economy. Their incidence is properly borne by the currency reserve, as otherwise they might un-necessarily disturb the stability of the economy.

The wastage of the coin reserve in Ceylon during the last depression represented the use of the reserve for the first of the two objects. In 1931 and 1932, when the drain was the severest, the Currency Commissioners lost Rs. 18.6 millions worth of silver and it was not until 1933, when, mainly through a drastic curtailment of the imports, the favourable trade balance was re-established, that the demand on the reserve completely stopped. The more or less automatic regularity with which, before the Great War I, the coin reserve increased from the late autumn until the early spring and decreased during the early summer months illustrated the use of the reserve for the second object.

The magnitude of the free reserve must be such as not only to meet the requirements of the seasonal or temporary contingencies, which in all normal times would be comparatively small, but also the sudden deficiencies arising out of a precipitate drop in the value of the exports or through a panicky withdrawal of foreign capital, the demands of which may be considerable. In fixing the amount of the reserve statutorily, however, these considerations are rarely, if ever, borne in mind. The more usual practice, based upon the continental and the American model, has been to prescribe it as a minimum proportion of the note circulation, with which, however, neither of the objects of the reserve bear any stable relationship and which has rather an empirical, than a well reasoned logical, foundation. The total amount of money in circulation, although it is, no doubt, influenced by variations in the trade balance, depends upon the level of the national income and the money using habits of the people.

Of the two portions of the reserve the first, as the demands on it are not likely to be frequent, need not necessarily be kept in cash. It can safely be invested in readily realizable short-term securities. The second portion, however, must be held in ready form, as it represents the 'till money' of the monetary authority. In Ceylon, as elsewhere, the seasons are not very clearly defined and the peak seasonal demand on the reserve is not precisely fixed, so that it is exceedingly important that sufficient cash must always be held in the reserve to meet these contingencies. The actual magnitude of the two portions of the reserve will vary from time to time, it will vary from country to country, and may be left to the discretion of the monetary authority. But, probably, in the case of Ceylon, which has not to reckon with fugitive foreign balances, the cash ratio may be small relatively to the liquidity ratio, which must be high.

Theoretically, therefore, a strong case seems to exist for leaving to the monetary authority full powers of discretion as to the size of the reserve as well as free use of the reserve, subject to such simple safeguards as may be necessary to ensure against (1) any chances of inflationary issue of currency and (2) a reduction of the reserve to dangerously low levels.¹ The reserve provision of the Ordinance seems to satisfy these considerations. It expressly excludes Ceylon Government securities from among securities

¹ Mr. Keynes has given the following formula as the theoretically most suitable one: 'If the law were to fix a minimum absolute figure for the gold reserve and a maximum absolute figure for the note circulation, both these figures being subject to reasonable revision from time to time and so chosen as to allow a wide discretion to the Central Bank in its day to day and year to year policies, I do not believe that there is any further safeguard which—however much it may be intended in the interests of prudence—will not render the country's currency system more, rather than less, precarious, sometimes compelling the Central Bank to take steps which are, in its own judgement, unwise and possibly dangerous'. *Treatise on Money*, Vol. II, p. 274.

eligible for inclusion in the Security Fund and there are not any special ways, other than those open to the public, by which the Government can secure the issue of notes from the Currency Board. There is no provision in the Ordinance for any advances being made by the Board to the Government. Like the public it can get notes only by the deposit of an equivalent amount (to the notes demanded) with the Reserve Bank of India (or with the Crown Agents under the sterling link). This seems to be a sufficient safeguard against inflationary finance, in normal times as, under the terms of the Ordinance, such finance is not possible without the co-operation of the Reserve Bank (or the Crown Agents). The second danger is guarded against by providing for the concurrence of the Governor before any reduction is made in the amount of the liquidity reserve.

X. *Surplus Assets*

The net profits of issue would go to the State and if the income of the Currency Board is insufficient to meet its disbursements the deficit must be made good out of the general revenue. The Security Fund must be allowed to grow up to 110 per cent¹ of its liabilities, through the contribution to it of one per cent of its amount out of the annual income (section 33). This codifies into law the long standing instruction of the Secretary of State that the Commissioners must always aim at a 110 per cent currency assets.² And, except for a period of 18 months, from October 1920 to March 1922 when, due to purely fortuitous

¹ Many countries maintain vastly larger surplus assets in their monetary reserve. In 1938, the Union of South Africa had a reserve in gold and foreign exchange of about 176 per cent of the note liability, Australia about 146 per cent, United States of America about 247 per cent, Netherlands about 148 per cent, Sweden about 137 per cent, and Switzerland about 178 per cent. See *Monthly Bulletin of Statistics*, League of Nations, August 1939.

² *Ceylon Hansard*, 1916, p. 337; *Report of the Colonial Auditor*, 1921-22, para. 163.

circumstances, the book value of currency assets fell short of the note liability, the Commissioners have always maintained surplus reserves as is shown by the table below. It will be noted that, since 1924, except for a break in 1929 and 1930, attributable to the rise in the exchange ratio to 18d., the reserve fund has remained over 110 per cent of the note liability.

TABLE XV

SURPLUS CURRENCY RESERVE

Source: Up to 1928 *Reports of the Colonial Auditor*;
thereafter *Reports of the Auditor-General*

(Rs. 1,000,000)

	A	B	C
Sept. 30	Gross note circulation	Deficit — or Excess + reserve	Percentage of B to A
1921	45·74	— 2·61	— 5·71
1922	39·30	+ 0·72	+ 1·83
1923	42·71	+ 1·81	+ 4·24
1924	47·99	+ 5·90	+ 12·29
1925	52·98	+ 5·91	+ 11·16
1926	61·73	+ 7·18	+ 11·63
1927	62·47	+ 7·41	+ 11·86
1928	57·44	+ 7·55	+ 13·14
1929	57·33	+ 4·84	+ 8·44
1930	57·22	+ 4·73	+ 8·27
1931	42·44	+ 4·80	+ 11·31
1932	41·97	+ 5·04	+ 12·01
1933	42·03	+ 5·55	+ 13·20
1934	43·08	+ 5·73	+ 13·30
1935	44·15	+ 5·88	+ 13·32
1936	44·33	+ 6·10	+ 13·76
1937	48·39	+ 6·44	+ 13·31
1938	45·08	+ 9·53	+ 21·14
1939	49·16	+ 9·61	+ 19·55

XI. *Publicity*

After the new Ordinance comes into force the monthly statements of accounts, and the annual profit and loss accounts, published by the Commissioners of Currency, under the old Ordinance, will cease to appear. The profit and loss accounts are not required to be published at all—they will be available only to the Governor and the Secretary of State—and, in place of the monthly statements, there will appear, once a year, an abstract of the currency position, under 8 specified heads, as at the 30th day of September of each year (section 34). This decision is exceedingly unfortunate and contrasts with the weekly balance sheets issued by a great many monetary authorities of the world. The Malay Currency Ordinance, 1938, provides for the publication of monthly statements, a half yearly summary, and an annual profit and loss account. Little is to be gained by excessive secretiveness. It gives room for false rumours which may prove a potential source of danger at all times and may accelerate panic or unnecessarily cause loss of confidence in the currency. It deprives the banks, the financiers, and the outside critic, of the only useful source of authentic information¹ about the currency position of the Island.

¹ Since 1937 the Commissioners of Currency have been issuing an annual *Administration Report*.

CHAPTER X

ALTERNATIVE MEASURES OF REFORM

I. Five Main Alternatives

IN this chapter we shall examine the alternative measures of currency reform which were open to the Government and the question of the desirability of establishing a central bank in Ceylon. When the Government formulated the new currency Ordinance, theoretically, they had before them five alternative bases of currency to choose from. They were as follows:—

1. A direct link with gold.
2. Restoration of the pre-1914 link with the silver rupee i.e. enforcement of the provisions of the existing currency law.
3. A direct link with sterling.
4. A link with the Indian legal tender through the sale and purchase of Indian exchange in place of the pre-1914 system of receiving and issuing rupee coins.
5. A simultaneous link with the Indian and the British currency units [i.e. combining alternatives (3) and (4)], leaving the choice as between sterling and Indian exchange in which to redeem the notes and against which to issue Ceylon currency (a) to the discretion of the currency authority and (b) to the option of the public.

Alternatives (1) and (2) may be at once ruled out. The failure of the attempts of the European countries to adopt the system of a direct link with gold (under which exchange

parity is kept up through dealings in gold coin, or gold bullion) on the British model, after their abandonment of silver or bimetallism during the last quarter of the 19th century, and the monetary history of a number of countries since then, in particular, the post-war currency history, have made it abundantly clear that almost the natural standard for overwhelmingly debtor countries like Ceylon is an exchange standard. To convert the sale proceeds of the surplus exports of such countries into gold, only to pay it out again to their foreign creditors, is an unnecessarily expensive process. It is much simpler and economical to keep them invested in a suitable foreign centre in readily realizable short-term, or other, securities, pending payment of the country's foreign liabilities. Apart from the interest derived from the investments, this policy saves the expense of moving gold backwards and forwards. Indeed, whatever standard the debtor countries may adopt in law, in practice, the standard is bound to approximate to an exchange standard as the experience of a number of countries has shown.

Alternative (2) the currency authority has been gradually upsetting, during the past two decades, and its adoption now would be to revert to a system which practical expediency has discarded as clumsy and unsuitable. The preference of the Commissioners to deal in exchanges rather than in rupee coins is in every way comparable to the tendency of the gold standard to function as an exchange standard in all debtor countries. Even as the gold standard countries, which have debts to pay, prefer credits, in a convenient foreign centre, to gold, in payment of the amounts due to them, similarly, Ceylon, rather than pay the expenses of importing rupees

and sending them back again to India, prefers to be paid in exchanges.

Among the remaining alternatives, it will be noted, none relate to a link with a currency other than the rupee and sterling. The economic and the financial relationship of the Island with no country, other than India and Great Britain, is sufficiently extensive to justify such a link. The table facing p. 216, which gives the percentage share in the foreign trade of the Island of the principal countries trading with it, brings this out prominently.

The greatest part of the Island's trade is with the Empire countries, principally Great Britain and India (including Burma).¹ Over one-third (before 1933 over 40 per cent) of the imports are from India and over 40 per cent, in recent years somewhat over one-half, of the exports are taken by the United Kingdom. India is by far the largest single supplier of the Island's imports and Great Britain the largest single buyer of Ceylon produce. Exports to India and imports from Great Britain are on a smaller, the former on an appreciably smaller, scale. But Great Britain comes next to India in the import trade of the Island. Taking imports and exports together the share of these two countries is both remarkably steady and considerable. During the period under review the share of the United Kingdom in the trade of the Island varied between 30.81 per cent (1928) and 36.64' per cent (1938)—most of the time it remained nearer one-third than these two limits—and that of India, except in 1934, remained above 20

¹ For purposes of this chapter British India is taken to include Burma, as, though separated from India since April 1937, it continues to be an integral part of the British Indian currency system.

per cent. The chief cause of the importance of India and the United Kingdom in the trade of the Island is that most of the necessities of life come from the former, and the bulk of the output of tea, the chief produce of the Island, is taken by the latter. The total share of the Empire countries in the Island's foreign trade has averaged 67.04 per cent. It has not fallen below 63.50 per cent.

The share of the remaining countries is inconsiderable individually. Among them the United States of America has played a more important part than the rest. But her share has been gradually on the decline. In 1925 the U. S. A. accounted for somewhat over 19 per cent of the Island's foreign trade. Year after year, it diminished in value and in 1932, when it reached a low ebb, it was only 5.57 per cent. The contribution of the other countries is even less. In the case of France and Belgium it has been below $1\frac{1}{2}$ per cent, Italy below 2 per cent, and Germany, whose share has been unsteady, and Japan, whose share has been slowly rising, below 4 per cent.

II. *The Choice between Sterling and the Indian Rupee*

As between alternatives (3) and (4) the choice must depend upon the magnitude of the relative indebtedness resulting from the economic and the financial relationship of the Island with Great Britain and India respectively i.e. upon the magnitudes of the sterling and rupee payments owed by the country on balance. In so far as visible items of trade are concerned this is indicated by the following table of the Island's trade balance with the United Kingdom, British India (including Burma), and the remaining countries considered together from 1924 to 1939:—

TABLE XVII

BALANCE OF TRADE

(Including specie and bullion)

Source: *Reports of the Principal Collector of Customs*
(Rs. 1,000,000)

	A	B	C	D	E
Year	U.K.	Rest	A + B	British India (including Burma)	Total Balance of Trade
1924	+102·87	+105·32	+208·19	—134·00	+ 73·19
1925	+ 93·83	+197·04	+290·87	—158·63	+132·24
1926	+113·19	+147·97	+261·16	—165·38	+ 95·78
1927	+ 92·73	+ 95·94	+188·67	—160·52	+ 28·15
1928	+ 60·45	+ 63·46	+123·91	—143·46	— 19·55
1929	+ 71·29	+ 38·17	+109·47	—132·39	— 21·93
1930	+ 73·18	+ 15·89	+ 89·07	—103·26	— 14·19
1931	+ 61·65	+ 2·86	+ 64·51	— 66·00	— 1·49
1932	+ 46·57	— 9·40	+ 37·17	— 63·23	— 26·06
1933	+ 61·52	+ 1·76	+ 63·28	— 57·44	+ 5·85
1934	+ 85·15	+ 7·52	+ 92·67	— 64·37	+ 28·29
1935	+ 71·94	+ 5·70	+ 77·64	— 69·58	+ 9·06
1936	+ 75·63	+ 32·88	+108·51	— 60·79	+ 37·72
1937	+ 90·25	+ 52·38	+142·63	— 69·27	+ 73·36
1938	+ 93·63	+ 30·92	+124·55	— 75·89	+ 48·66
1939	+105·81	+ 59·99	+165·80	— 78·74	+ 87·06

The table throws into relief with great plainness several striking features of the foreign trade of the Island. Trade with the United Kingdom, as always, shows a vastly favourable balance. Though the depression greatly diminished its magnitude, it was never in danger of being wiped out or reversed. In 1932, which was the leanest year, it was still Rs. 46·57 millions. With the revival of trade and the increased demand for tea, it steadily rose.

In six years it doubled in value, having risen to Rs. 93.63 millions in 1938. Trade balance with the remaining countries (other than India), considered together, is also normally favourable. But it is subject to very wide fluctuations. In the sixteen years under review it ranged between a positive balance of Rs. 197.04 millions (1925) and a negative balance of Rs. 9.40 millions (1932). During 1931 and 1933 it hovered precariously above the zero point.

Trade balance with India, on the contrary, has been habitually adverse. During the period we are considering, the adverse balance was never less than 57.44 millions (1933) and was as much as 165.38 millions (1926). As imports from India comprise necessities of life like rice and grain, other articles of food, and coarse cloth worn by the masses, and as Ceylon produces few commodities which it can successfully offer to India, the magnitude of the passive trade balance with the country cannot be easily reduced. On the contrary, it tends naturally to increase with the prosperity of the Island even as the favourable trade balance with the remaining countries increases at such times.

The table clearly brings out the traditional principle underlying the distribution of the foreign trade of Ceylon. The Island obtains from India and Burma the necessities of life in exchange for the surplus sale proceeds in the European countries, chiefly the United Kingdom, of the produce of its plantations and mines. In all normal times exports to the European countries are sufficient to pay for the purchase of manufactured articles and invisible imports from them, and still leave a surplus to meet the bills arising out of the Indian imports. But, from 1928 to 1932 as the result of a precipitate fall in the price of the staple produce of the Island, namely, tea, rubber, and coconut, the surplus credits fell short of the amounts

required to liquidate the adverse balance with India. In 1933, however, partly through a rise in the price of tea and rubber, which followed the International Restriction Schemes for the two commodities, but mainly by a drastic curtailment of the imports, chiefly manufactures from Great Britain and Europe generally, the Island was able to clear in full its current Indian (trade) indebtedness, which was now on a considerably reduced scale, and leave a small surplus. The position greatly improved in the following year, but suffered a reverse in 1935, though the general trade balance was still positive. In 1936, it revived again and more than regained the lost ground. In the next year the net surplus, after meeting the Indian (trade) debt, was Rs. 73.36 millions. It declined in 1938 but more than recovered in the following year.

The reflex of this situation in the sphere of finance is that trade remittances to the United Kingdom in payment of imports and to the remaining countries (other than India) generally, is never a serious problem with the Island. Indeed, trade with the United Kingdom has always provided it with vast surplus credits, shown in column A, after paying for all the imports from the country. This has also held true, except in 1932, of the countries included in column B taken together. But in relation to India, ever since trade statistics were recorded, the position has been just the reverse. Rupee bills payable in India have always been scarce relatively to the demand for them and, year after year, the Island has had to draw upon surplus export credits elsewhere, to pay for Indian imports.

Inclusion of invisible items of trade does not modify, but emphasises, the general character of the geographical distribution of the current indebtedness of the Island as shown by the trade figures. Estimates of invisible imports and exports have been made by the Government of Ceylon for the years (April-March) 1931-32 to 1937-38. The

following table, which is based upon these estimates,¹ gives the surplus invisible imports into the Island.

TABLE XVIII

SURPLUS INVISIBLE IMPORTS INTO CEYLON

(Rs. 1,000,000)

			A	B	C	D
Year			Europe	India	Unclassified	Total
1931-32	...	...	13.50	6.00	35.02	54.52
1932-33	...	...	12.00	5.00	27.49	44.49
1933-34	...	...	13.50	6.00	35.17	54.67
1934-35	...	...	15.11	6.50	46.71	68.32
1935-36	...	...	14.04	6.23	39.32	59.59
1936-37	...	...	12.73	6.10	42.80	61.63
1937-38	...	...	19.49	6.02	-16.00	9.51
Total ...			100.37	41.82	210.51	352.72

Figures in columns A and B represent only a portion of the surplus invisible imports from Europe and India, respectively. They comprise, in the case of the former, remittances by European residents in Ceylon, and their expenditure when on leave and in the latter case, remit-

¹ I am indebted to Mr. J. C. W. Roßk, late Director of Commerce and Industries, and to Mr. D. H. Balfour, his successor in office, for allowing me access to these official estimates, of which only those for the years 1931-32 and 1932-33 have been published so far. See *Administration Report of the General Treasury for 1936*, pp. J55 and J56.

I must state that the Government does not vouch for the accuracy of these estimates. But, as we are primarily concerned with the relative, rather than with the exact magnitudes of the invisible trade balances of the Island with the main groups of countries, any allowance for the probable margins of error will not altogether destroy the utility of the estimates for purposes of our argument.

tances to India through the Post Office. They do not include, payments on account of interest and dividend, Government disbursements, remittances made through banks, private bankers, etc. These come under column C which also covers countries other than India and those not included in column A. The actual figures of surplus invisible imports from Europe and India, therefore, would be considerably larger than those given in the table. Of the amount in column C the largest share would go to the United Kingdom, a lesser part to India, and the balance would be distributed among the remaining countries. If we assume that the whole of the amount in column A and $\frac{3}{4}$ that in column C goes to the credit of the United Kingdom, the total sterling payments owing by Ceylon to the country on account of invisible items for the six years ending with 1936-37 would be Rs. 250.76 millions. During the same period the total sterling credits available in the United Kingdom, representing Ceylon's surplus exports to the country, were about Rs. 361.46 millions or Rs. 110.70 millions in excess of the demands of invisible imports. In the case of India, on the contrary, the adverse trade balance position is accentuated by the amount of the excess invisible imports into the Island from the country, which must be appreciably more than what is indicated by figures in column C. Payments due to India, in other words, are much larger than what the trade statistics show.

The upshot of the situation, then, is that, in normal years as well as in years of depression, large amounts are owed by Ceylon to India: while in times of prosperity payments due to the Island from other countries are sufficient, or more than sufficient, to meet the Indian demand, in lean years, they need to be supplemented through other sources. Speaking generally such deficits are met usually in three ways: by acquiring temporary credits in foreign

centres; by raising long-term loans abroad or by a voluntary inflow of foreign capital; and by drawing upon the currency reserve.¹ Debtor countries find the first method difficult, especially in emergencies, and the presence of the second depends upon the certainty and sufficiency of the profits on investments. The first two methods failing, the deficit has to be made good out of the currency reserve.

In the past Ceylon has availed of the second and third methods. Owing to the free inflow of foreign capital, coupled with the willingness on the part of the non-Ceylonese capitalists to reinvest in the Island profits earned locally, the pressure on the currency reserve to fill the gap has not been very considerable. From 1928 to 1932, for instance, the Island's adverse trade balance (including import and export of specie and bullion) was Rs. 83.22 millions (to which must be added the payments due on surplus invisible imports to arrive at the correct figure of the total current debts due abroad). But during the same interval the currency reserve (both coin and securities) fell only by Rs. 22.66 millions. Apparently, the rest of the adverse trade balance of Rs. 60.56 millions, plus the invisible surplus debt, was made good by the inflow of foreign capital.² In recent years, however, owing to several factors, among them the failure of tea, rubber, and coconut, fully to recover from the depression, International Restriction Schemes in tea and rubber, and the widely held apprehension that the old prosperity, which the Island had traditionally enjoyed, may never return, foreign capital has shown increasing reluctance to seek investment or re-investment in the country. If this situation should continue, a return of bad years and the reappearance of successive years of adverse trade balance may possibly

¹ Creditor countries have a fourth method in their ability to transfer to their creditors foreign securities held by them.

² Allowance has been made for the net export of specie and bullion.

cause a much greater drain on the currency reserve than had been the case during 1928-1932.

As noted in a previous chapter, when the foreign accounts of the Island do not balance, the disequilibrium is reflected in the scarcity of the means of remittance to India. It seems but reasonable, therefore, that the currency reserve must be kept preferably in Indian exchange rather than in sterling. That is to say, to return to the enquiry which had led us to examine the Island's trade returns, a strong case seems to exist in favour of alternative (4), rather than alternative (3) i.e. in favour of linking the Ceylon currency to the Indian monetary unit rather than to sterling.

III. *Possible Cost of the Sterling Link*

To keep the currency reserve in sterling i.e. to link the Ceylon currency to the British monetary unit [alternative (3)], would seem to serve very poorly the requirements of the situation. The Ceylon rupee would then be redeemed in sterling and Ceylon rupees would be issued in exchange for sterling. That is to say, in times of passive trade balance, or when the export surplus is meagre and falls short of the needs of invisible imports, importers of Indian goods, in order to pay for the goods (foreign exchange being unavailable), will have to convert Ceylon rupees received in return for them, first into sterling at the office of the Currency Commissioners, and sterling so received into Indian money. If at this time the Indian exchange were to be at the upper sterling point, conversion of sterling will have to be done by offering sterling to the Reserve Bank of India at the latter's buying rate (Rs. 6 $\frac{3}{8}$ d.). In other words, assuming that, on the Indian analogy, the selling rate of sterling of the Ceylon currency authority would be $\frac{15}{16}$ d. below par, remittance of funds

to India might cost up to a maximum of $\frac{3}{4}$ d. per rupee or 2.34 per cent.¹ Under a rupee exchange standard, assuming that the currency authority did not charge for drafts on India in redemption of the notes more than the maximum commission levied by the banks today, the corresponding cost would not exceed $\frac{1}{4}$ per cent. The high cost of exchange would disappear if the Ceylon rupee could be converted directly into Indian exchange instead of via sterling.

Actually, however, the cost of exchange will seldom, or never, equal the maximum of 2.34 per cent. For, it is extremely improbable that the Indian exchange would be at the upper sterling point when the Ceylon exchange remained at the lower sterling point. The economic condition of the two countries being not very much dissimilar, the causes of adverse trade conditions responsible for deterioration of the Island's exchange position, in part, at least, are likely to influence Indian trade conditions as well. Nevertheless, the comparatively large range of commodities which makes up Indian exports, her self sufficiency in the matter of food supply, and the rapid progress of her industrialization, make it less likely that the effect of the same causes on the exchanges of the two countries would continue to be similar in the future. If, therefore, Ceylon exchange falls by a greater margin than the Indian exchange for a given cause, the cost of remittances to India in payment of Indian imports would be correspondingly higher under a sterling exchange system than under a direct link with India. The theoretical limit of the cost (or the limit of the discount of Ceylon currency against the Indian rupee) would be 2.34 per cent, while, under a rupee exchange standard, it may not exceed 0.25 per cent.

¹ Sterling has been converted into rupees at the par rate of 1s. 6d.

The higher cost of exchange will have to be borne by the Indo-Ceylonese trade for apparently little or no compensating reward. In point of stability of exchange with the outside world and security over long periods, a link with India is as good as a link with sterling, since the Indian currency is linked to sterling. Very probably the greater part, if not the full amount of the incidence of the higher cost, will fall upon the Ceylon consumer of the Indian merchandise. For, it largely comprises necessities of life which have a low elasticity of demand and there are not any competing sources of supply to induce the Indian exporters to bear a portion of the cost. In this connection it is noteworthy that the whole of the import duty on rice and incidental charges such as wharfage, landing dues, etc., are passed on by the importers to the consumer. In 1936 the Port Health authorities in Colombo levied a charge of 1½c. per bag of rice to defray the cost of fumigation. The levy was promptly shifted by the importers to the retailer who collected it from the consumer.

A link with sterling may also prejudice the flow of emergency funds from India as well as employment in the Indian call loan market of the temporary surplus funds which, since the depression, the Ceylon banks have often possessed. If funds must come from India the ruling rate in Ceylon at the time must be higher than the Indian rate by a margin sufficient to cover the cost of conversion between the two currencies and to leave some profits. The extreme variation between the best and the worst terms on which Indian and Ceylon currencies can be exchanged under the present system is limited by twice the cost of shipping rupee coins from Ceylon to India or a maximum of 0.5 per cent. For loans of three months, the possible cost of exchange would require that the Ceylon rate of Interest should be higher than the Indian rate at least by 2 per cent per

annum, in order to induce banks to borrow in India.¹ Similarly, the interest obtainable in the Indian call market must be at least 2 per cent, to eliminate the possible risk of loss of shifting temporarily to India surplus balances from Ceylon and of bringing them back again. Under a sterling exchange standard the interest rate differential (or the minimum call rate) must be appreciably higher, to eliminate the possible higher risk of moving funds as between the two countries. Assuming the difference between the best and the worst terms on which Ceylon and Indian currencies can be interchanged, under the sterling link, to be 2.84 per cent,² the Ceylon rate must be higher than the Indian rate at least by 11.36 per cent per annum or the call rate in India must be at least as high for funds to move in the opposite direction. That is to say, whenever the Indian and Ceylon exchanges remain in their opposite extremes, the Ceylon banking system would be virtually disconnected from the Indian money market, which is nearest to it, as, on such occasions, the risk of moving funds in either direction would become prohibitive. On other occasions, though the actual cost of the transfer of funds may be less, because of the greater risk, Indian money may not flow in with the same freedom as now and idle Ceylon balances may not find the same easy opportunity of making a small gain through investment in India. This may possibly have the effect of increasing the interest rate differential as between India and Ceylon for short term money. It may also cause seasonal variation in the money rates, from which the system is so largely free today.

¹ This factor partly explains the higher interest rates in Ceylon relatively to the rates in India. According to the Ceylon Banking Commission the Ceylon rates are as much as '5, 6, and even 7 per cent' when 'banks (in India) are anxious to lend at $3\frac{1}{2}$ per cent.' See *Sessional Paper XXII of 1934*, para. 200.

² This figure is arrived at by adding 0.5 per cent, which we have assumed to be the maximum cost at which Ceylon and Indian currencies could be exchanged under the present system, to the distance between the sterling exchange points of the Ceylon currency.

IV. *The Simultaneous Link with Sterling and the Indian Rupee*

Alternative (5) might render the system un-necessarily complicated. If the choice between the rupee and sterling were left to the option of the public (5a), it would be necessary to keep enough stock of sterling as well as rupee exchange in the reserve, both in a sufficiently liquid form. Failure to do so might throw the system into jeopardy if the demand for the conversion into one of the two currencies were to persist. If, on the contrary, an attempt was made to hold sufficiently large liquid resources in both currencies, too great a proportion of the reserve might have to remain idle or in short-term securities yielding but a nominal rate of interest. This would negative one of the chief benefits of the exchange system, which should normally permit investment of a good proportion of the currency reserve in reasonably remunerative form.

If the choice between the two currencies were left to the discretion of the monetary authority [alternative (5b)], there would enter into the system a wholly un-necessary uncertainty, which may have harmful consequences. Businessmen, who had hoped to buy rupee drafts from the currency authority, might suddenly find that, as the result of a change of policy, they were offered only sterling, or those who had sterling to sell might similarly discover that rupee exchange alone was now acceptable to the currency authority. The banks may not find it safe to import emergency capital from India for fear of loss on exchange, which would follow, if their anticipations were upset by the Currency Commissioners deciding to deal in sterling, instead of in rupee exchange, when it was time to send the funds back to India. Thus, the system, on the one hand would not have the advantages of a simple link

with the Indian currency and on the other would not be devoid of the short-comings of a link with sterling.

This leaves us with the only alternative of a rupee exchange standard, which, if we ignore the provision for the optional link with sterling, was the course followed in the Paper Currency Ordinance, 1939. In terms of our alternatives the Ordinance combined with alternative (4) the option to change over to alternative (3), if certain circumstances were to materialize.

V. *The Case for a Central Bank*

Before we conclude reference must be made to the question of the desirability of establishing a central bank in the Island. The past two decades have witnessed the creation of central banking institutions in a number of countries. In the early part of this period establishment of new central banks, or reorganization of existing ones, to conform to the prevailing ideas of 'independent' banks of issue, had become a world fashion. The Brussels International Financial Conference of 1920 had resolved that 'in countries where there was no Central Bank of Issue one should be established' and that banks 'especially a Bank of Issue should be freed from political pressure and should be conducted solely on the lines of prudent finance.' During the next decade the advice of this conference was widely followed. New central banks were formed and many existing banks of issue, notably the Reichsbank and the central banks of Belgium and Norway, were either drastically over-hauled (Reichsbank) or important changes were introduced in their constitution and policy (Belgium and Norway). The countries that previously formed part of the Austrian and Russian Empires, certain of the Balkan States, some of the South American Republics and South Africa established new central banks.¹

¹ C. H. Kisch and E. W. Elkin, *Central Banks*, London, 1928, p. 2.

Since the Brussels conference, the importance of a central bank to the financial system of a country was repeatedly emphasised by various bodies from time to time, especially in connection with the desirability of promoting international co-operation in the realm of currency, exchange, and finance.¹ The question was reiterated by the London International Monetary and Economic Conference of 1933. The conference considered it to be 'essential, in order to provide an international gold standard with the necessary mechanism for its satisfactory working, that independent Central Banks with the requisite powers and freedom to carry out an appropriate currency and credit policy, should be created in such developed countries as have not at present an adequate Central Banking institution.'

The London conference was as fruitful of results as the Brussels conference of 1920. It was followed by a fresh wave of central bank creation or central bank reorganization. New banks of issue were formed in a number of countries which had escaped the movement of the 'twenties. Central banks were established in New Zealand, Arabia and Afghanistan in 1934, and in Canada, India and the Argentine in 1935. One of the early acts of Germany, after the annexation of Czechoslovakia in 1938, was to create a separate central bank for the Slovak Republic.

In certain other countries some already existing banking institutions, such as the Commonwealth Bank of Australia, the Central Bank of Ecuador and the Bank of the Republic of Paraguay, have been gradually, or by definite legislative acts, transformed into central banks, working on modern lines, by eliminating private business and concentrating upon the task of regulating the volume of currency and credit. In still others, with a view to increasing their control over the money market, the central

¹ See *Fifth Annual Report of the B.I.S.*, pp. 102-03.

banks are being armed with special powers notably in the sphere of direct action in the open market.¹ The Irish Banking Commission of 1938 has proposed the reorganization of the Free State Currency Commission with additional powers appropriate to a central bank, and the question of granting a fresh royal charter to the National Bank of Egypt in order to assure its privileges and responsibilities as a central bank is, at present, nearing settlement.² To-day there are but few territories, outside the British Colonial Empire, of any economic significance, which do not own a central bank. Many of them have a lesser magnitude of foreign trade than Ceylon, and a lesser or comparable volume of note circulation, commercial bank deposits and numbers of the population.³

¹ See *Fifth Annual Report of the B.I.S.*, pp. 102-03.

² *The Economist*, April 8, 1939, p. 107 and May 20, 1939, p. 451.

³ This is brought out by the following table:—

TABLE XIX

(Amount in Million U. S. gold dollars—Population in millions—Area in thousand kilometers)

Source: *Statistical Year-Book of the League of Nations*, 1937-38.

Year: 1937.

	A	B	C	D	E	F
Country	Area	Popu- lation	Commer- cial bank deposits	Note circula- tion	C + D	Foreign trade
Ceylon ...	66	5·67	26·90 †	10·67	37·57	134·23
Albania ...	28	1·10	...	2·12	...	5·4
Ecuador ...	455	3·00	4·24	3·54	7·78	14·8
Estonia ...	48	1·13	13·81	6·62	20·43	35·1
Peru ...	1249	7·00	37·92 *	14·21	52·13	90·7
Uruguay ...	187	2·07	42·09	29·83	60·70	83·0

It will be noted that the value of the foreign trade of all the countries mentioned in the table is smaller, in the case of some appreciably smaller, than that of Ceylon, the numbers of the population of all but one is less, and the note circulation and bank deposits higher only in the case of Peru and Uruguay.

† See footnote 3 on p. 236 below.

* Rupees have been converted into gold dollars at the prevailing rate of exchange.

The foregoing review raises the question whether Ceylon, too, should follow the course of world fashion and establish a central bank of its own. In support of this temptation it is possible to advance a number of other arguments as well. In the absence of a lender of last resort the banks, today, obtain emergency funds from the Imperial Bank of India, their rival in business. The latter lends out to them Government deposits and the 'Indian' moneys of its Indian branches lying in Colombo pending transfer to India. When the liquid funds of the Imperial Bank are inadequate to meet the demands of the banks the alternative provided by the law is to await the arrival of a shipment of coins from the mainland. In either case, however, the banking system depends upon India for emergency accommodation. For, it is a mere question of machinery whether rupees are physically imported by the banks or the 'Indian' funds in the possession of one of them is made use of instead. It is but a convenient and common banking device of 'importing' funds. These facilities, however, it may be argued, cannot be a permanent substitute to the rediscount facilities, or facilities for advances against approved securities, provided by a central bank at its published minimum rates.

The dependence of a banking system for these facilities, upon another banking system needs to be avoided. Under a separate liquidity mechanism in the form of a central bank, the banks, and, therefore, trade and industry, might be able to raise credit in times of emergency at a somewhat lesser cost than under the present arrangement.

Government activities in a modern State comprise a considerable part of its total economic activities. They are estimated to be, as a rule, fully 25 per cent of the total.¹ In times of war the proportion is considerably higher. The

¹ *Irish Banking Commission Report*, 1938, p. 231.

implementing of even the peacetime policies, therefore, has a decisive influence on monetary developments sometimes of a highly disturbing character. In other ways also, through its commercial policies, for instance, a Government can, and does, cause serious monetary repercussions. In order not to subject the monetary mechanism to unnecessarily heavy strain, which may prove fatal to its soundness and stability, the monetary authority must be aware of the policy of the Government in the financial and commercial spheres sufficiently in advance so as to enable it to call the attention of the Government to the monetary aspects of the policy before any final decision is taken. It is the duty of a modern central bank to tender such advice to the Government. Among the subjects, which demand consultation and counsel of the central bank, may be mentioned, coinage and banking legislation, public borrowing, public works department policy, policy of the State-owned or State-controlled industries, policies which affect commodity prices, cost of production, balance of payments, etc. At present, there is no agency in Ceylon to advise the Government on the monetary reactions of their policy in relation to these subjects, as the Government itself is the monetary authority, currency issue being controlled by Government officials as a part time duty.

The economic and the financial activities of the Government of Ceylon, as compared with the aggregate economic activities of the Island, are appreciable. In addition to the normal Governmental activities as reflected in the annual budget, the Government owns and manages the Ceylon Government Railways, the only railway system in the Island, and the Department of Electrical Undertakings, which supplies electricity to Colombo and Nuwara Eliya and runs the Hydro-Electric Works at Watala. It owns or has a controlling hand in the management of the Ceylon Savings Bank, the Post Office Savings Bank and the State Mortgage

Bank. The Government are bankers to the Widows' and Orphans' Pension Fund, the Ceylon University Building and Equipment Fund, and hold large surpluses of their own in the form of the General Reserve Fund and the Special Reserve Fund built up out of the excess of revenue over expenditure in the past years. The financial importance of these several activities is indicated by the following table :—

TABLE XX

Source : *Reports of the Auditor-General*

(Rs. 1,000,000)

	A	B	C	D	E		
Year ¹	Capital and Reserve of the Government and semi-Government Commercial Bodies, and the permanent funds held by the Government ²	Deposits of the Ceylon Savings Bank and the Post Office Savings Bank	Percentage of B to the total Bank Deposits for 1933 ³ (Rs. 122 Millions)	(Gross) Revenue from the Railway and the Electrical Departments	General Revenue of Government	D + E	Percentage of D + E to the estimated national income for 1936* (Rs. 600 Millions)
1934	290.14	24.97	20.47	23.12	104.10	127.22	21.20
1935	290.37	27.65	22.66	20.46	98.99	119.45	19.91
1936	282.06	31.24	25.61	19.23	102.77	122.00	20.33
1937	294.73	36.25	29.71	19.13	119.20	138.33	23.06
1938	293.20	38.46	31.52	19.15	113.35	132.50	22.08
1939	282.21	39.22	32.15	18.45	116.93	135.38	22.56

¹ The figures are as at 31st December or 30th September of each year.

² This column includes, the capital invested in the Ceylon Government Railways and the Government Electrical Undertakings as at September 30

It will be noted that, for the period under review, except 1935, the total revenue at the disposal of the Government (D+E) has been over 20 per cent of the estimated national income.

The case for a central banking institution seems to receive further support in the increasing practice of co-operation among the monetary authorities of the world. If the authority is a Government department there are obvious practical difficulties in the way of offering effective co-operation. The importance of such co-operation lies in the interdependence of the monetary systems of the world and the desirability of it was again and again urged by various bodies and authorities eminently competent to speak on the subject.¹ It was recommended by the Geneva Conference, 1922, and re-emphasised by the Macmillan Report on Finance and Industry, 1931, by the successive studies of the Gold Delegation of the Finance Committee

of each year, the accumulated reserve of the Ceylon Savings Bank and the Post Office Savings Bank as at December 31 of each year, the debentures outstanding and the reserve of the State Mortgage Bank as at September 30 of each year, the General Reserve Fund and the Special Reserve Fund created out of the accumulated surplus revenues by a resolution of the State Council (March 27, 1935), and the Revenue Surplus as at September 30 of each year.

* Neither the Government nor the banks publish the amount of the bank deposits in the Island. The Banking Commission of 1934, however, gives a consolidated deposit figure of the exchange banks and the Imperial Bank of India as at December 31, 1933, which is Rs. 122 millions. The percentage in column C is based upon this figure.

* The Department of Commerce and Industries has estimated the national income for 1936 to be roughly Rs. 600 millions. (*Ceylon Trade Journal*, Vol. IV, No. 5, p. 210.) The percentage in the last column is based upon this estimate.

¹ For a review of the importance and benefits of central bank co-operation see Kisch and Elkin, pp. 146 et seq., and the *Fifth Annual Report of the B.I.S.*, pp. 41 et seq.

of the League of Nations, by the London Monetary and Economic Conference, 1933, by the countries of the now defunct 'gold bloc' and, almost year after year, by the reports of the Bank for International Settlements.

The Commissioners of Currency have been faced, several times, with situations which required concerted action with the monetary authority in India. During the latter part of the Great War I and the immediate post-war period the problems of the two monetary authorities were more or less identical. First they centred round the question of financing the essential war exports and of bringing back to India and Ceylon the accumulated export credits in London. Mutual consultations, which this gave rise to, were further necessitated by the complications which followed the embargo on the export of silver from India. To save the Ceylon system from utter collapse it was necessary that exception should be made in the case of exports to Ceylon. But at the same time such an exception could not be allowed to act as an endless drain on the silver resources of the Indian monetary authority. A way out of the difficulty was found through negotiation whereby the Imperial Bank was granted special licenses to import rupees from India. During the period of monetary instability, and the period of *de facto* stabilisation which followed it, close co-operation between the two countries in the interest of both was very necessary.

In recent years, during the second half of 1938, the Currency Commissioners, in order to implement a change in their investment policy, had to dispose of Rs. 101.86 lacs worth of Government of India rupee paper for re-investment of the proceeds in sterling securities. So as not to depress the market for the former, which might have reduced the amount realized on them, as well as to arrange for its remittance to the Crown Agents at favourable

rates, the Commissioners found it beneficial to avail of the co-operation of the Reserve Bank of India. This the bank willingly offered to the Imperial Bank of India, which acted for the Commissioners, and the operations were concluded with remarkable success.

VI. *The Case against a Central Bank*

It is arguable, however, whether these considerations are a sufficient justification for installing the costly machinery of an independent bank of issue in the Island. Many of the newer central banks especially those in countries which have not any well developed short-term money market have not been able to command sufficient influence over their respective banking systems. Most of them, particularly some of the more recent creations, are not so much the result of the internal growth of the banking system calling for a central bank as superimpositions from above. Indeed the history and current experience of many of them has made it apparent that, the process of adaptation and gradual evolution of monetary institutions, in response to altering circumstances, has produced more successful results than indiscriminate adoption of alien organizations and technique unrelated to the needs of local circumstances.¹

The financial organization of the Island is exceedingly simple. It begins and very nearly ends with the commercial banks. There is no money market in Ceylon, as in the great majority of countries, outside the commercial banks. The working of the system is not complicated by

¹ The Bank of England and the Federal Reserve System, for instance, are too often regarded as prototypes of a central bank. But it is not always realized that their success is due to the highly developed credit systems of London and New York, in the absence of which most of their powers and technique would be almost wholly purposeless.

the presence of short-term investments held on account of foreigners or investment abroad of any appreciable amounts of domestic short-term funds, the movements of all of which may demand constant vigil on the part of the monetary authority. There are not any marked seasonal variations in the money rates, which may call for remedial direct action in the open market on the part of the monetary authority and, since the latter part of the Great War I, apart from lasting changes in the volume of currency, which may be attributed to structural adjustments in the economy consequent upon non-seasonal alterations in the volume of production and trade (see chart facing p. 240 below and that facing p. 158 above), currency issue reveals hardly any pronounced seasonal fluctuations.

The Government hardly, probably never, find it necessary to borrow from the market in order to meet its current expenditure. It is in the happy position of having its revenue as well as expenditure more or less evenly spread throughout the year. Such temporary deficiencies in the income as may sometimes occur are small—they are never more than a few lacs—and are capable of being easily met out of the large cash balances lying to the credit of the general Assets of the Island, the available portion of which in Ceylon, runs into several millions. There is thus no Government demand for ways and means advances nor are there any Treasury bills to be issued.

The Government's sterling remittances or, to use the phrase common to Indian finance, Home Charges, are small relatively to the size of the normal export surplus and unlike the Home Charges of the Government of India do not dominate the exchange market nor give rise to any 'remittance problem'. The tables below give figures of the sterling requirements of the Governments of India and Ceylon, the sterling purchases of the Indian monetary

authority, and their relation to the respective export surpluses of the two countries :—

TABLE XXI

HOME CHARGES AND STERLING PURCHASES,
OF THE GOVERNMENT OF INDIA

Source : *Statistical Abstracts for British India*

(Crores of Rupees)

	A	B	C	D	E
Year ¹	Purchase of sterling by the monetary authority	' Home Charges ' ²	Surplus exports ³	Per-centage of A to C	Per-centage of B to C
1931-32	53·04	41·19	90·48	58·62	45·52
1932-33	47·23	39·40	68·15	69·30	56·85
1933-34	59·97	38·48	90·90	65·97	42·33
1934-35	49·82	38·00	75·96	65·59	50·03
1935-36	45·58	38·13	66·92	68·11	56·98
1936-37	70·87	36·59	92·26	76·82	39·66
1937-38	7·26	41·89	37·63	19·29	111·32

¹ Indian financial year (April-March).

² Includes all expenditure in England charged to Revenue or Capital, Annual Surplus or Deficit, or Cash Balances.

³ Includes imports and exports of specie.

TABLE XXII

STERLING PAYMENTS OF THE GOVERNMENT OF CEYLON

Source: *Administration Reports of the General Treasury*
(Crores of Rupees)

	A	B	C
Year ¹	Sterling disbursements made by the Crown Agents on account of Ceylon	Surplus exports ³	Percentage of A to B
1935-36 ²	2.34	37.72	6.20
1936-37	2.08	73.36	2.84
1937-38	2.56	48.66	5.26
1938-39	2.53	87.06	2.91

It will be noted that the sterling purchases of the Indian monetary authority for the years under review, except 1937-38, when abnormal conditions prevailed, varied from 58.62 per cent to as much as 76.82 per cent of the country's export surplus. Home Charges absorbed from 39.66 per cent (1936-37) to 56.98 per cent (1935-36) of the surplus. The Home Charges of the Government of Ceylon, on the contrary, did not exceed 6.20 per cent of the Island's excess exports during the four years for which figures are available. The Crown Agents are kept in funds in order to meet Ceylon's sterling payments in four several ways:⁴—

(1) The Treasury purchases (or discounts) the three days' sight bills drawn by the Command Paymaster on His Majesty's Treasury to meet the military and the naval

¹ Financial year (October-September).

² Figures for previous years have not been published.

³ Figures in this column are for calendar years beginning with 1936.

⁴ *Administration Report of the General Treasury for 1936*, p. J8.

expenditure in Ceylon chargeable to the Imperial Exchequer, which it sends to the Crown Agents for collection. (2) The bulk of the remittance, however, is made through the exchange banks. Sterling is bought (mostly T.T. and sometimes also D.D.), instead of by inviting tenders, as in India, over the telephone, the most advantageous among the offers made by the banks being accepted. (3) When sufficient sterling is not available for remittance, or in times of emergency, the Crown Agents are instructed to realize investments held by them on account of the Surplus Funds or (4) asked to borrow temporarily from the Joint Colonial Fund.

The locally available portion of the cash balances of the Government on account of revenue receipts, proceeds of loans, general Assets, etc., are not locked up in any independent treasury system. They are distributed among the principal banks in Colombo, namely, the Imperial Bank of India, the Mercantile Bank, the National Bank of India, the Chartered Bank of India, Australia and China, the Hong-Kong and Shanghai Banking Corporation, the Eastern Bank, and, after its commencement in August 1939, the Bank of Ceylon. To each one of the exchange banks has been allotted the balances of one or more of the several Government departments. The revenues from customs and income tax are credited to the account with the Imperial Bank of India which, consequently, gets the bulk of the balances. The cash balances of the Government abroad are held chiefly by the Crown Agents and a small portion by the Imperial Bank of India, Madras. The balances at Madras are maintained for the purpose of collecting the interest falling due on Indian securities and to make payments in India on various accounts.¹ The cash balances of the Government as at September 30, and the balances of the Ceylon Savings Bank and the Post Office Savings

¹ *Administration Report of the General Treasury for 1936*, p. J6.

Bank as at December 31, of each year from 1932 to 1939 are given below :—

TABLE XXIII

GOVERNMENT'S CASH BALANCES

Source: *Reports of the Auditor-General*

(Rs. 1,000,000)

Date	Cash balances of	Available in Ceylon	Deposits with the Crown Agents	Deposits in India with the Imperial Bank of India	Total	Percentage of Treasury balances in Ceylon to total bank deposits (Rs. 122 millions) ¹
Sep. 30, 1932	General Treasury	11.92	8.47	0.14	20.53	9.75
Dec. 31, 1932	P.O.S.B. & C.S.B.	2.52	...	...	2.52	...
Sep. 30, 1933	General Treasury	16.71	14.35	0.35	31.41	13.69
Dec. 31, 1933	P.O.S.B. & C.S.B.	1.17	...	...	1.17	...
Sep. 30, 1934	General Treasury	18.49	10.16	0.33	28.98	15.10
Dec. 31, 1934	P.O.S.B. & C.S.B.	1.36	...	...	1.36	...
Sep. 30, 1935	General Treasury	11.74	2.06	0.03	13.83	9.59
Dec. 31, 1935	P.O.S.B. & C.S.B.	5.28	...	...	5.28	...
Sep. 30, 1936	General Treasury	8.66	2.81	0.03	11.50	7.13
Dec. 31, 1936	P.O.S.B. & C.S.B.	3.45	...	...	3.45	...
Sep. 30, 1937	General Treasury	12.60	16.76	0.49	29.85	10.33
Dec. 31, 1937	P.O.S.B. & C.S.B.	1.42	...	...	1.42	...
Sep. 30, 1938	General Treasury	7.12	12.27	0.02	19.41	5.82
Dec. 31, 1938	P.O.S.B. & C.S.B.	1.40	...	...	1.40	...
Sep. 30, 1939	General Treasury	6.95	3.30	0.02	10.27	5.70
Dec. 31, 1939	P.O.S.B. & C.S.B.	0.65	...	...	0.65	...

¹ See footnote 3 on p. 236 above.

This arrangement seems to have worked satisfactorily. The banks which share Government funds are large and, (except for the Bank of Ceylon which is only a year and a few months old), longstanding institutions. There has never arisen any doubt as to the safety of the funds entrusted to them. Government money having always remained in the market, the Island was never faced with problems such as those which had been a vexed feature in the days of independent treasury systems in the U.S.A. and India. Receipts and expenditure being more or less evenly distributed throughout the year Government operations do not upset money conditions in the market which may call for stabilising action by a central bank.

In the absence of a money market there does not exist any real necessity for a central bank and when this situation is accompanied by the absence of a security market of any dependable capacity, the usefulness of a central bank as a means of credit regulation would be closely circumscribed,¹ as its powers of action would then be limited.²

¹ For a discussion of the problems of central banking in financially backward countries see R. S. Sayers, *Modern Banking*, London, 1939, pp. 287 et seq.

² In the absence of a wide money market outside the banks the technical conditions for the use of open market operations are quite different from those of the highly developed money markets like London and New York. Their utility as a device of credit control and regulation would be limited, even as powers to influence the forward exchange rates would be a superfluous adornment to a central bank in the absence of a forward exchange market. Open market operations, moreover, need skilful handling to be successful or not to be followed by harmful consequences. It presupposes not only a detailed preliminary study, but also the realization of certain conditions such as an adequate supply of securities in the reserve to enable absorption of surplus funds in the market and a well developed and large security market which would readily receive, as well as sell, securities of the eligible type, so that the central bank may as easily buy securities as reverse the operations at the appropriate time in order to maintain unimpaired its liquidity position.

It seems significant, therefore, that until the last few years, when there has been visible a general tendency to increase central bank control over

Moreover, as the experience of more than one country has shown, it will not be easy, at any rate at an early date, to induce the commercial banks into indebtedness to a newly founded central bank in order that it may make use of such indebtedness to control the terms and volume of commercial bank credit.

It would be no easy task for a central bank to wrest from the Imperial Bank of India the central position which the latter has always occupied in the financial structure of the Island. It will be noted that it owes this position not to any legislative enactment, or to any undue official patronage, but almost wholly to natural economic forces—the influence over the currency and exchange position which it is able to wield by virtue of the control which it has over the finance of the Island's trade with India and cognate factors. Under these conditions the Imperial Bank is likely to occupy the centre of the picture in all normal times and the commercial banks would probably find it convenient to act through the Imperial Bank, in their dealings with the central bank, more or less in the same way as they do today in their dealings with the Commissioners of Currency. Having been in the habit, almost traditionally, of acting as one man in such situations, the temptation to do so after the coming of a reserve bank is not likely to be less, as the experience of South Africa has shown. Moreover, little is to be gained by attempting to alter the present arrangement of inter-bank relations.

The Imperial Bank is the settling bank by general

the money market by legislation, the means of action permissible to a great many of the central banks did not include freedom to buy or to sell securities in the open market on their own initiative. For instance, though the Dutch banking system is one of the oldest in Europe and the Amsterdam money market one of the most highly developed, yet it was not until February 1937, that the *Nederlandsche Bank* was authorized to undertake open market operations of a limited type. See *Seventh Annual Report of the B.I.S.*, p. 97.

approval, and, in the absence of compulsion, the banks may not welcome any other clearing arrangement. Clearing through a central bank would mean that they would either be deprived of the advantages of keeping an account with the Imperial Bank (which they find convenient in their exchange clearing transactions) or they would have to keep, without any great countervailing advantages, two accounts, one with the central bank and the other with the Imperial Bank.

The new Currency Ordinance would enable Ceylon banks to raise emergency currency in exchange for their surplus purchases of sterling from the Currency Board. It does not seem necessary, therefore, to instal a central bank for this purpose. In the absence of the habit of bill finance, bankers' acceptances and a local discount market, any provision for rediscount facilities can have no practical value.

VII. *Full-time Currency Commissioners*

But perhaps the time has arrived to appoint full-time Commissioners of Currency (or one full-time Commissioner with a Currency Board to assist and advise him) in place of the present arrangement. The working of the system before the Great War I was strikingly simple. As over the rest of the world, where the gold standard prevailed, the functioning of the system in Ceylon was more or less automatic. It was governed by a few fairly simple rules so that the system could be subjected to routine management by Government officials as a part-time duty. All that the Commissioners had to do was to receive, and to issue, rupee coins in exchange for currency notes. No doubt so long as Ceylon is attached to the Indian rupee, (and the Indian rupee is attached to the pound sterling), the system would continue to function under almost equally automatic

conditions, currency being expanded or withdrawn as the state of the exchanges might dictate. Nevertheless it is less simple than the pre-1914 system and probably more sensitive. Furthermore, administration of the Paper Currency Ordinance of 1939, some of the provisions of which are elastic, involves the exercise of a great measure of discretion, among other things, in the matter of reserves (their distribution as between London and Bombay and their liquidity), and the fixing of the rates of commission for the mutual conversion of Ceylon currency and Indian exchange. These duties of the Commissioners would require careful study of the state of the security market in Bombay and London, the general money conditions in the two centres, and the trend of the exchanges in Ceylon, India and Great Britain, within their fixed limits. The problems of the optional link with sterling, also add to their responsibilities. Under the present arrangement the Commissioners have to discharge other, and equally onerous, duties and responsibilities. There seems to exist, therefore, sufficient ground for entrusting the problems of currency issue to the care of full-time Currency Commissioners.

APPENDIX I

CURRENCY STATISTICS

Source: Monthly Statements of
the Commissioners of Currency

Note:—

(1) 'Coin in vault' includes, from December 1916 to August 1920 (in which month the sovereign was demonetized), sterling credits in London held by the Crown Agents on behalf of the Commissioners of Currency.

It includes also 'Cash at call at Madras, pending shipment of rupees', which frequently appeared in the statements for 1920 and 1921 and occasionally thereafter.

(2) The legal minimum reserve has been taken as one-third the note circulation from December 1916.

(3) Figures are in lacs of rupees.

1900	Note circulation	Securities in the reserve			Coin in vault	Surplus + or deficit — coin reserve	
		Total	Rupee	Ster- ling			
January ...	141.52	63.02	35.07	27.95	78.50	+	7.74
February...	139.12	do.	do.	do.	76.10	+	6.54
March ...	130.87	do.	do.	do.	67.85	+	2.41
April ...	121.62	do.	do.	do.	58.60	—	2.21
May ...	120.57	do.	do.	do.	57.55	—	2.74
June ...	116.92	do.	do.	do.	53.90	—	4.56
July ...	134.07	do.	do.	do.	71.05	+	4.01
August ...	138.47	do.	do.	do.	75.45	+	6.21
September.	129.37	do.	do.	do.	66.35	+	1.66
October ...	133.77	do.	do.	do.	70.75	+	3.86
November.	139.22	70.14	do.	35.07	69.08	+	0.53
December .	132.92	do.	do.	do.	62.78	—	3.68

1901	Note circulation	Securities in the reserve			Coin in vault	Surplus + or deficit — coin reserve
		Total	Rupee	Ster- ling		
January ...	127·67	70·14	35·07	35·07	57·53	— 6·31
February...	118·82	do.	do.	do.	48·68	— 10·73
March ...	108·46	do.	do.	do.	38·32	— 15·91
April ...	104·46	do.	do.	do.	34·32	— 17·91
May ...	102·56	do.	do.	do.	32·42	— 18·86
June ...	114·06	do.	do.	do.	43·92	— 13·11
July ...	118·31	do.	do.	do.	48·17	— 10·99
August ...	120·81	do.	do.	do.	50·67	— 9·74
September.	121·56	do.	do.	do.	51·42	— 9·36
October ...	120·26	do.	do.	do.	50·11	— 10·02
November.	130·59	do.	do.	do.	60·44	— 4·86
December .	132·14	do.	do.	do.	61·99	— 4·08
1902						
January ...	114·56	70·14	35·07	35·07	44·42	— 12·86
February...	106·89	do.	do.	do.	36·74	— 16·71
March ...	100·23	do.	do.	do.	30·08	— 20·04
April ...	102·46	do.	do.	do.	32·32	— 18·91
May ...	101·66	do.	do.	do.	31·52	— 19·31
June ...	107·31	do.	do.	do.	37·17	— 16·49
July ...	112·96	61·74	do.	26·67	51·22	— 5·26
August ...	124·34	60·74	do.	25·67	63·59	+ 1·42
September.	122·40	59·51	33·84	do.	62·89	+ 1·69
October ...	138·72	do.	do.	do.	79·21	+ 9·85
November.	139·55	do.	do.	do.	80·04	+ 10·26
December .	138·68	do.	do.	do.	79·17	+ 9·83
1903						
January ...	133·72	59·51	33·84	25·67	74·21	+ 7·35
February...	120·37	do.	do.	do.	60·86	+ 0·67
March ...	126·73	do.	do.	do.	67·22	+ 3·85
April ...	124·96	59·43	33·76	do.	65·53	+ 3·05
May ...	122·44	do.	do.	do.	63·01	+ 1·79
June ...	119·36	do.	do.	do.	59·93	+ 0·25
July ...	132·77	do.	do.	do.	73·33	+ 6·94
August ...	148·40	do.	do.	do.	88·97	+ 14·77
September.	163·21	74·43	do.	40·67	88·77	+ 7·16
October ...	171·11	83·93	39·76	44·17	87·18	+ 1·62
November .	182·24	91·93	45·76	46·17	90·31	— 0·81
December .	171·11	do.	do.	do.	79·18	— 6·38

1904	Note circulation	Securities in the reserve			Coin in vault	Surplus + or deficit — coin reserve	
		Total	Rupee	Ster- ling			
January ...	134.57	89.93	43.76	46.17	44.64	—	22.65
February...	135.20	do.	do.	do.	45.27	—	22.33
March ...	131.19	do.	do.	do.	41.26	—	24.34
April ...	118.71	71.21	25.04	do.	47.49	—	11.87
May ...	127.85	67.75	21.58	do.	60.10	—	3.83
June ...	127.04	66.28	20.11	do.	60.75	—	2.77
July ...	123.96	do.	do.	do.	57.68	—	4.30
August ...	126.51	do.	do.	do.	60.23	—	3.03
September.	137.08	do.	do.	do.	70.80	+	2.26
October†...	...	...	...	...	...	...	...
November.	136.39	66.28	20.11	46.17	70.11	+	1.91
December .	137.96	68.26	22.09	do.	69.70	+	0.72
1905							
January ...	135.18	69.25	23.08	46.17	65.93	—	1.66
February...	136.22	do.	do.	do.	66.97	—	1.14
March ...	135.99	do.	do.	do.	66.73	—	1.27
April ...	130.92	do.	do.	do.	61.66	—	3.80
May ...	129.21	do.	do.	do.	59.96	—	4.65
June ...	125.22	do.	do.	do.	55.97	—	6.64
July ...	128.41	do.	do.	do.	59.16	—	5.05
August ...	125.68	do.	do.	do.	56.43	—	6.41
September.	123.31	do.	do.	do.	54.06	—	7.60
October ...	127.27	do.	do.	do.	58.01	—	5.63
November .	136.37	do.	do.	do.	67.11	—	1.08
December .	135.77	do.	do.	do.	66.51	—	1.38
, 1906							
January ...	125.28	69.25	23.08	46.17	56.02	—	6.62
February...	124.59	do.	do.	do.	55.34	—	6.96
March ...	126.79	do.	do.	do.	57.54	—	5.86
April ...	126.29	do.	do.	do.	57.04	—	6.11
May ...	142.18	69.33	do.	46.25	72.85	+	1.76
June ...	141.26	71.17	24.92	do.	70.08	—	0.55
July ...	143.07	do.	do.	do.	71.89	+	0.35
August ...	145.36	73.17	26.92	do.	72.18	—	0.50
September.	154.72	78.08	31.83	do.	76.63	—	0.73
October ...	153.70	do.	do.	do.	75.61	—	1.24
November.	169.36	80.68	34.43	do.	88.68	+	4.00
December .	175.29	92.34	46.09	do.	82.95	—	4.70

† Figures not published in the *Gazette*.

1907	Note circulation	Securities in the reserve			Coin in vault	Surplus + or deficit - coin reserve
		Total	Rupee	Ster- ling		
January ...	157·38	92·34	46·09	46·25	65·04	— 13·65
February...	150·35	do.	do.	do.	58·01	— 17·17
March ...	152·91	do.	do.	do.	60·57	— 15·89
April ...	148·43	do.	do.	do.	56·09	— 18·13
May ...	153·76	do.	do.	do.	61·42	— 15·46
June ...	161·94	do.	do.	do.	69·60	— 11·37
July ...	157·39	do.	do.	do.	65·04	— 13·66
August ...	160·42	do.	do.	do.	68·08	— 12·13
September.	173·68	do.	do.	do.	81·34	— 5·50
October ...	167·67	do.	do.	do.	75·33	— 8·51
November.	167·39	do.	do.	do.	75·04	— 8·66
December .	167·68	do.	do.	do.	75·34	— 8·50
1908						
January ...	164·65	92·34	46·09	46·25	72·31	— 10·02
February...	158·39	do.	do.	do.	66·05	— 13·15
March ...	151·36	do.	do.	do.	59·02	— 16·66
April ...	140·30	do.	do.	do.	47·96	— 22·19
May ...	143·22	do.	do.	do.	50·87	— 20·74
June ...	139·96	86·36	40·11	do.	53·59	— 16·39
July ...	135·80	do.	do.	do.	49·43	— 18·47
August ...	137·93	do.	do.	do.	51·56	— 17·41
September.	153·42	do.	do.	do.	67·05	— 9·66
October ...	157·00	do.	do.	do.	70·60	— 7·90
November.	160·53	do.	do.	do.	74·16	— 6·11
December.	157·48	do.	do.	do.	71·11	— 7·63
1909						
January ...	152·84	86·36	40·11	46·25	66·47	— 9·95
February...	151·84	do.	do.	do.	65·47	— 10·45
March ...	150·53	do.	do.	do.	64·17	— 11·10
April ...	145·76	do.	do.	do.	59·40	— 13·48
May ...	142·82	do.	do.	do.	56·46	— 14·95
June ...	141·71	do.	do.	do.	55·35	— 15·51
July ...	142·13	do.	do.	do.	55·77	— 15·30
August ...	172·76	do.	do.	do.	86·40	+ 0·02
September.	169·25	do.	do.	do.	82·88	— 1·75
October ...	173·90	do.	do.	do.	87·53	+ 1·05
November.	168·13	do.	do.	do.	81·76	— 1·23
December.	172·50	do.	do.	do.	86·13	— 2·08

1910	Note circulation	Securities in the reserve			Coin in vault	Surplus + or deficit - coin reserve	
		Total	Rupee	Ster- ling			
January ...	168.55	86.36	40.11	46.25	82.18	-	2.10
February...	171.13	do.	do.	do.	84.76	-	0.81
March ...	173.08	do.	do.	do.	86.71	+	0.17
April ...	184.40	89.60	43.35	do.	94.80	+	2.60
May ...	181.64	91.86	45.61	do.	89.78	-	1.04
June ...	193.42	do.	do.	do.	101.56	+	4.85
July ...	199.25	93.80	47.55	do.	105.45	+	5.82
August ...	211.13	95.80	do.	48.25	115.33	+	9.76
September.	227.33	100.68	52.43	do.	126.65	+	12.98
October ...	231.55	do.	do.	do.	130.87	+	15.09
November.	228.85	do.	do.	do.	128.17	+	13.74
December .	232.20	108.63	do.	56.20	123.57	+	7.47
1911							
January ...	227.75	108.63	52.43	56.20	119.12	+	5.24
February...	208.25	do.	do.	do.	99.62	-	4.51
March ...	203.11	do.	do.	do.	94.48	-	7.08
April ...	200.96	do.	do.	do.	92.33	-	8.15
May ...	199.52	do.	do.	do.	90.89	-	8.87
June ...	197.37	do.	do.	do.	88.74	-	9.95
July ...	198.62	do.	do.	do.	89.99	-	9.32
August ...	212.32	do.	do.	do.	103.69	-	2.47
September.	226.42	do.	do.	do.	117.79	+	4.58
October ...	234.27	do.	do.	do.	125.64	+	8.50
November .	238.90	113.61	57.41	do.	125.29	+	5.84
December .	235.95	do.	do.	do.	122.34	+	4.36
1912							
January ...	232.52	114.99	57.40	57.59	117.53	+	1.27
February...	220.37	do.	do.	do.	105.38	-	4.81
March ...	214.22	do.	do.	do.	99.23	-	7.88
April ...	212.17	do.	do.	do.	97.18	-	8.91
May ...	209.97	do.	do.	do.	94.98	-	10.01
June ...	211.47	do.	do.	do.	96.48	-	9.26
July ...	213.07	do.	do.	do.	98.08	-	8.46
August ...	217.52	do.	do.	do.	102.53	-	6.23
September.	227.92	do.	do.	do.	112.93	-	1.03
October ...	236.37	do.	do.	do.	121.38	+	3.19
November .	232.84	117.51	do.	60.11	115.33	-	1.09
December .	231.83	117.52	do.	60.12	114.31	-	1.61

1913	Note circulation	Securities in the reserve			Coin in vault	Surplus + or deficit - coin reserve	
		Total	Rupee	Ster- ling			
January ...	226·35	119·88	57·40	62·48	106·46	—	6·72
February...	223·20	do.	do.	do.	103·31	—	8·29
March ...	222·50	do.	do.	do.	102·61	—	8·64
April ...	216·60	do.	do.	do.	96·71	—	1·59
May ...	209·70	do.	do.	do.	89·81	—	15·04
June ...	234·62	do.	do.	do.	114·74	—	2·57
July ...	247·13	do.	do.	do.	127·24	+	3·67
August ...	280·73	135·78	do.	78·38	144·94	+	4·57
September.	289·50	140·61	do.	83·21	148·84	+	4·11
October ...	301·46	151·61	do.	94·21	150·24	—	0·69
November.	301·71	do.	do.	do.	150·09	—	0·77
December .	296·76	do.	do.	do.	145·14	—	3·24
1914							
January ...	292·01	151·61	57·40	94·21	140·39	—	5·62
February...	288·46	do.	do.	do.	136·84	—	7·39
March ...	279·81	do.	do.	do.	128·19	—	11·72
April ...	278·41	do.	do.	do.	126·79	—	12·42
May ...	271·56	do.	do.	do.	119·94	—	15·84
June ...	267·71	do.	do.	do.	116·09	—	17·77
July ...	276·25	do.	do.	do.	124·63	—	13·50
August ...	287·37	do.	do.	do.	135·76	—	7·93
September.	279·02	do.	do.	do.	127·41	—	12·10
October ...	269·34	do.	do.	do.	117·72	—	16·95
November.	269·97	do.	do.	do.	118·35	—	16·64
December .	266·30	do.	do.	do.	114·68	—	18·47
1915							
January ...	275·87	151·61	57·40	94·21	124·25	—	13·69
February...	275·37	do.	do.	do.	123·75	—	13·94
March ...	270·72	do.	do.	do.	119·10	—	16·26
April ...	271·12	do.	do.	do.	119·50	—	16·06
May ...	272·56	do.	do.	do.	120·94	—	15·32
June ...	268·61	do.	do.	do.	116·99	—	17·37
July ...	264·00	do.	do.	do.	112·39	—	19·61
August ...	258·33	do.	do.	do.	106·71	—	22·46
September.	273·26	do.	do.	do.	121·64	—	14·99
October ...	268·78	do.	do.	do.	117·16	—	17·23
November.	273·53	do.	do.	do.	121·91	—	14·86
December .	268·53	do.	do.	do.	116·91	—	17·36

1916	Note circulation	Securities in the reserve			Coin in vault	Surplus + or deficit — coin reserve
		Total	Rupee	Ster- ling		
January ...	264.43	151.61	57.40	94.21	112.81	— 19.41
February...	262.83	do.	do.	do.	111.21	— 20.21
March ...	259.03	do.	do.	do.	107.41	— 22.11
April ...	261.33	do.	do.	do.	109.71	— 20.96
May ...	262.73	do.	do.	do.	111.11	— 20.26
June ...	270.15	do.	do.	do.	118.54	— 16.46
July ...	276.05	do.	do.	do.	124.44	— 13.59
August ...	271.95	do.	do.	do.	120.34	— 15.64
September.	278.85	do.	do.	do.	127.24	— 12.19
October ...	290.91	do.	do.	do.	139.30	— 6.16
November.	288.57	do.	do.	do.	136.96	— 7.33
December.	333.27	181.61	do.	124.21	151.66	+ 40.57
1917						
January ...	387.37	181.61	57.40	124.21	205.76	+ 76.64
February...	386.17	do.	do.	do.	204.56	+ 75.84
March ...	381.91	do.	do.	do.	200.30	+ 73.00
April ...	379.77	do.	do.	do.	198.16	+ 71.57
May ...	380.23	do.	do.	do.	198.62	+ 71.88
June ...	410.73	193.11	98.90	94.21	217.62	+ 80.71
July ...	411.99	do.	do.	do.	218.88	+ 81.55
August ...	393.25	do.	do.	do.	200.14	+ 68.36
September.	388.75	do.	do.	do.	195.64	+ 66.06
October ...	389.09	do.	do.	do.	195.98	+ 66.28
November.	389.21	do.	do.	do.	196.10	+ 66.36
December.	389.47	do.	do.	do.	196.35	+ 66.53
1918						
January ...	389.91	193.11	98.90	94.21	196.79	+ 66.82
February...	384.17	do.	do.	do.	191.05	+ 62.99
March ...	378.15	do.	do.	do.	185.23	+ 59.11
April ...	372.69	do.	do.	do.	179.57	+ 55.34
May ...	372.97	do.	do.	do.	179.85	+ 55.53
June ...	373.07	do.	do.	do.	179.95	+ 55.59
July ...	373.15	do.	do.	do.	180.03	+ 55.65
August ...	373.23	do.	do.	do.	180.11	+ 55.70
September.	373.41	do.	do.	do.	180.29	+ 55.82
October ...	do.	do.	do.	do.	do.	do.
November.	do.	do.	do.	do.	do.	do.
December.	373.43	do.	do.	do.	180.31	+ 55.83

1919	Note circulation	Securities in the reserve			Coin in vault	Surplus + or deficit — coin reserve
		Total	Rupee	Ster- ling		
January ...	373·43	193·11	98·90	94·21	180·31	+ 55·83
February...	do.	do.	do.	do.	do.	do.
March ...	373·47	do.	do.	do.	180·35	+ 55·86
April ...	373·51	do.	do.	do.	180·39	+ 55·89
May ...	373·75	do.	do.	do.	180·63	+ 56·05
June ...	374·88	do.	do.	do.	181·76	+ 56·80
July ...	374·90	do.	do.	do.	181·78	+ 56·81
August ...	404·90	225·45	88·80	136·65	191·79	+ 56·82
September.	405·33	225·51	do.	136·71	192·22	+ 57·11
October ...	405·86	do.	do.	do.	192·75	+ 57·46
November.	406·10	249·15	108·81	140·34	192·99	+ 57·62
December .	466·41	289·98	148·80	141·18	213·30	+ 57·82
1920						
January ...	496·49	290·14	148·80	141·34	243·38	+ 77·88
February...	496·77	do.	do.	do.	243·66	+ 78·07
March ...	497·76	321·80	do.	173·00	214·65	+ 48·77
April ...	497·82	324·28	do.	175·48	214·71	+ 48·76
May ...	498·05	do.	do.	do.	214·94	+ 48·92
June ...	499·17	405·45	do.	256·65	138·06	— 28·33
July ...	481·09	407·92	do.	259·12	118·68	— 41·68
August ...	472·13	334·33	152·51	181·82	163·33	+ 5·95
September.	471·90	do.	do.	do.	163·12	+ 5·82
October ...	481·96	298·65	177·18	121·47	148·51	— 12·14
November.	481·58	299·08	do.	121·90	148·38	— 12·15
December .	481·64	do.	do.	do.	148·44	— 12·11
1921						
January ...	481·68	299·59	177·18	122·41	148·53	— 12·03
February...	481·76	300·46	do.	123·28	148·61	— 11·98
March ...	481·84	299·66	do.	122·48	148·69	— 11·92
April ...	457·24	279·11	152·51	126·60	148·75	— 3·66
May ...	457·30	279·54	do.	127·03	148·81	— 3·62
June ...	457·22	280·70	do.	128·19	148·43	— 3·98
July ...	457·28	281·73	do.	129·21	148·49	— 3·94
August ...	457·32	282·50	do.	129·99	148·54	— 3·90
September.	457·34	282·64	do.	130·13	148·56	— 3·89
October ...	do.	282·71	do.	130·20	do.	do.
November.	do.	287·04	do.	134·53	do.	do.
December .	457·36	do.	do.	do.	148·58	— 3·87

1922	Note circulation	Securities in the reserve			Coin in vault	Surplus + or deficit - coin reserve	
		Total	Rupee	Ster- ling			
January ...	457·38	286·75	152·51	134·24	148·60	—	3·86
February...	do.	do.	do.	do.	do.		do.
March ...	457·40	288·44	do.	135·93	148·62	—	3·85
April ...	392·82	251·46	do.	98·95	148·60	+	17·69
May ...	392·86	do.	do.	do.	148·64	+	17·92
June ...	do.	do.	do.	do.	do.		do.
July ...	do.	do.	do.	do.	do.		do.
August ...	392·88	do.	do.	do.	148·66	+	17·70
September.	392·86	do.	do.	do.	148·64	+	17·69
October ...	do.	do.	do.	do.	do.		do.
November.	392·96	262·38	180·86	81·52	do.	+	17·65
December .	do.	do.	do.	do.	do.		do.
1923							
January ...	392·98	262·38	180·86	81·52	148·66	+	17·67
February...	do.	do.	do.	do.	do.		do.
March ...	392·96	do.	do.	do.	148·64	+	17·65
April ...	do.	do.	do.	do.	do.		do.
May ...	396·81	do.	do.	do.	152·49	+	20·22
June ...	397·05	do.	do.	do.	152·73	+	20·38
July ...	do.	do.	do.	do.	do.		do.
August ...	do.	do.	do.	do.	do.		do.
September.	do.	do.	do.	do.	do.		do.
October ...	407·01	303·15	do.	122·29	162·69	+	27·02
November.	417·01	do.	do.	do.	172·69	+	33·69
December .	427·07	do.	do.	do.	182·75	+	40·39
1924							
January ...	428·47	303·36	180·86	122·50	184·15	+	41·33
February...	428·39	do.	do.	do.	184·07	+	41·27
March ...	429·36	do.	do.	do.	185·04	+	41·92
April ...	429·34	do.	do.	do.	185·02	+	41·91
May ...	do.	do.	do.	do.	do.		do.
June ...	do.	do.	do.	do.	do.		do.
July ...	429·18	do.	do.	do.	184·86	+	41·80
August ...	430·02	do.	do.	do.	185·70	+	42·36
September.	470·02	do.	do.	do.	225·70	+	69·03
October ...	479·98	do.	190·86	112·50	225·66	+	65·67
November.	479·96	313·43	190·83	122·60	do.		do.
December .	479·94	do.	do.	do.	225·64	+	65·66

1925	Note circulation	Securities in the reserve			Coin in vault	Surplus + or deficit — coin reserve
		Total	Rupee	Ster- ling		
January ...	479.94	313.43	190.84	122.60	225.64	+ 65.66
February...	do.	do.	do.	do.	do.	do.
March ...	do.	do.	do.	do.	do.	do.
April ...	479.82	do.	do.	do.	225.52	+ 65.58
May ...	do.	do.	do.	do.	do.	do.
June ...	do.	do.	do.	do.	do.	do.
July ...	479.80	do.	do.	do.	225.50	+ 65.57
August ...	do.	do.	do.	do.	do.	do.
September.	529.77	323.40	200.80	do.	do.	+ 48.91
October ...	559.71	334.67	do.	133.87	225.44	+ 38.87
November.	do.	358.80	do.	158.00	do.	do.
December .	579.71	do.	do.	do.	do.	+ 32.20
1926						
January ...	579.71	394.90	200.80	194.10	225.44	+ 32.20
February...	579.61	395.00	do.	194.20	225.34	+ 32.14
March ...	579.39	413.96	do.	213.10	225.12	+ 31.99
April ...	579.15	do.	do.	do.	224.88	+ 31.83
May ...	578.85	418.61	do.	218.00	224.58	+ 31.63
June ...	578.65	419.70	do.	219.09	224.38	+ 31.50
July ...	578.45	420.69	do.	220.08	224.18	+ 31.36
August ...	598.11	426.04	do.	225.43	243.84	+ 44.47
September.	617.27	do.	do.	do.	243.00	+ 37.24
October ...	616.69	425.83	do.	225.22	242.42	+ 36.86
November.	628.27	448.33	do.	247.33	254.00	+ 44.58
December .	627.45	do.	do.	do.	253.18	+ 44.03
1927						
January ...	627.21	448.33	200.80	247.53	252.94	+ 43.87
February...	626.93	do.	do.	do.	252.66	+ 43.68
March ...	626.45	do.	do.	do.	252.18	+ 43.36
April ...	626.09	448.36	do.	247.56	251.82	+ 43.12
May ...	625.53	do.	do.	do.	251.26	+ 42.75
June ...	625.29	do.	do.	do.	251.02	+ 42.59
July ...	625.17	do.	do.	do.	250.90	+ 42.51
August ...	625.05	do.	do.	do.	250.78	+ 42.43
September.	624.75	do.	do.	do.	250.48	+ 42.23
October ...	624.65	do.	do.	do.	250.38	+ 42.16
November.	624.75	do.	do.	do.	250.48	+ 42.23
December .	624.71	do.	do.	do.	250.44	+ 42.20

1928	Note circulation	Securities in the reserve			Coin in vault	Surplus + or deficit - coin reserve	
		Total	Rupee	Ster- ling			
January ...	624·51	448·36	200·80	247·56	250·24	+	42·07
February ...	599·39	448·38	do.	247·58	225·12	+	25·32
March ...	574·17	423·38	175·80	do.	224·90	+	33·51
April ...	574·21	do.	do.	do.	224·94	+	33·54
May ...	574·03	do.	do.	do.	224·76	+	33·42
June ...	574·57	424·77	177·07	247·70	225·29	+	33·77
July ...	574·48	do.	do.	do.	225·21	+	33·72
August ...	574·39	do.	do.	do.	225·11	+	33·65
September.	574·37	do.	do.	do.	225·09	+	33·63
October ...	574·31	397·42	do.	220·35	225·03	+	33·59
November.	574·21	do.	do.	do.	224·93	+	33·53
December .	574·17	do.	do.	do.	224·89	+	33·50
1929							
January ...	574·03	397·42	177·07	220·35	224·75	+	33·41
February...	573·93	do.	do.	do.	224·65	+	33·34
March ...	573·86	do.	do.	do.	224·59	+	33·30
April ...	573·74	397·36	do.	220·29	224·47	+	33·22
May ...	573·68	do.	do.	do.	224·41	+	33·18
June ...	573·60	do.	do.	do.	224·33	+	33·13
July ...	573·54	do.	do.	do.	224·27	+	33·09
August ...	573·36	397·71	177·41	220·30	224·09	+	32·97
September.	573·28	do.	do.	do.	224·01	+	32·92
October ...	573·10	do.	do.	do.	223·83	+	32·80
November .	572·96	do.	do.	do.	223·69	+	32·70
December .	572·92	do.	do.	do.	223·65	+	32·68
1930							
January ...	572·78	397·70	177·41	220·29	223·51	+	32·58
February...	572·64	do.	do.	do.	223·37	+	32·49
March ...	572·42	do.	do.	do.	223·15	+	32·34
April ...	572·34	do.	do.	do.	223·07	+	32·29
May ...	572·32	397·71	do.	220·30	223·05	+	32·28
June ...	572·30	do.	do.	do.	223·03	+	32·23
July ...	do.	do.	do.	do.	do.		do.
August ...	572·28	396·56	do.	219·15	223·01	+	32·25
September.	572·19	do.	do.	do.	222·92	+	32·19
October ...	572·09	do.	do.	do.	222·82	+	32·12
November.	do.	do.	do.	do.	do.		do.
December .	do.	do.	do.	do.	do.		do.

1931	Note circulation	Securities in the reserve			Coin in vault	Surplus + or deficit - coin reserve
		Total	Rupee	Ster- ling		
January ...	567·07	396·56	177·41	219·15	217 80	+ 28·78
February...	514·53	359·23	139·91	219·32	202·76	+ 31·25
March ...	457·01	339·74	120·42	do.	165·24	+ 12·90
April ...	457·37	340·45	do.	220·03	165·60	+ 13·14
May ...	457·35	do.	do.	do.	165·58	+ 13·13
June ...	438·38	330·56	110·45	220·11	156·61	+ 10·48
July ...	438·41	do.	do.	do.	156·64	+ 10·50
August ...	do.	330·57	do.	220·12	do.	do.
September.	424·41	do.	do.	do.	142·64	+ 1·17
October ...	418·35	330·74	do.	220·29	136·58	- 2·87
November.	418·37	330·73	do.	220·28	136·60	- 2·86
December .	do.	do.	do.	do.	do.	do.
1932						
January ...	418·31	330·73	110·45	220·28	136·62	- 2·82
February...	418·39	do.	do.	do.	do.	- 2·84
March ...	418·37	do.	do.	do.	136·60	- 2·86
April ...	418·41	330·79	do.	220·34	136·64	- 2·83
May ...	do.	do.	do.	do.	do.	do.
June ...	do.	330·94	do.	220·49	do.	do.
July ...	418·47	do.	do.	do.	136·70	- 2·79
August ...	418·79	331·15	do.	220·70	137·02	- 2·58
September.	419·67	332·17	do.	221·72	137·90	- 1·99
October ...	419·65	333·20	do.	222·75	137·88	- 2·00
November.	419·67	do.	do.	do.	137·90	- 1·99
December .	419·65	334·10	do.	223·65	137·88	- 2·00
1933						
January ...	419·67	334·10	110·45	223·65	137·90	- 1·99
February...	do.	do.	do.	do.	do.	do.
March ...	419·69	do.	do.	do.	137·92	- 1·98
April ...	419·67	334·31	do.	223·86	137·90	- 1·99
May ...	420·05	335·96	do.	225·51	138·28	- 1·74
June ...	420·33	336·34	do.	225·89	138·56	- 1·55
July ...	420·31	337·31	do.	226·86	138·54	- 1·56
August ...	420·29	337·43	do.	226·98	138·52	- 1·58
September.	do.	337·32	do.	226·87	do.	do.
October ...	420·61	337·62	do.	227·17	138·84	- 1·36
November.	420·59	do.	do.	do.	138·82	- 1·38
December .	420·61	337·68	do.	227·23	138·84	- 1·36

1934	Note circulation	Securities in the reserve			Coin in vault	Surplus + or deficit — coin reserve
		Total	Rupee	Ster- ling		
January ...	420·61	337·82	110·52	227·30	138·84	— 1·36
February ...	420·63	337·86	do.	227·34	138·86	— 1·35
March ...	420·61	do.	do.	do.	138·84	— 1·36
April ...	420·65	do.	do.	do.	138·88	— 1·34
May ...	420·61	337·91	do.	227·39	138·84	— 1·36
June ...	do.	338·25	do.	227·73	do.	do.
July ...	do.	do.	do.	do.	do.	do.
August ...	430·85	338·43	do.	227·91	139·08	— 4·54
September.	430·83	338·91	do.	228·39	139·06	— 4·55
October ...	430·89	343·05	do.	232·53	139·12	— 4·51
November.	440·85	do.	do.	do.	139·08	— 7·87
December .	440·93	do.	do.	do.	139·16	— 7·82
1935						
January ...	440·95	353·07	110·52	242·55	139·18	— 7·80
February ...	do.	353·08	do.	242·56	do.	do.
March ...	440·97	353·30	do.	242·78	139·20	— 7·79
April ...	441·01	do.	do.	do.	139·24	— 7·76
May ...	do.	359·48	do.	248·96	do.	do.
June ...	441·13	360·12	do.	249·60	139·36	— 7·68
July ...	441·19	do.	do.	do.	139·42	— 7·64
August ...	441·37	360·27	do.	249·75	139·60	— 7·52
September.	441·47	do.	do.	do.	139·70	— 7·46
October ...	441·81	do.	do.	do.	140·04	— 7·23
November.	442·25	do.	do.	do.	140·48	— 6·94
December .	442·42	do.	do.	do.	140·65	— 6·82
1936						
January ...	442·50	360·27	110·52	249·75	140·73	— 6·77
February ...	442·72	360·47	do.	249·95	140·95	— 6·62
March ...	442·83	do.	do.	do.	141·06	— 6·55
April ...	442·99	361·24	do.	250·72	141·22	— 6·44
May ...	443·05	do.	do.	do.	141·28	— 6·40
June ...	443·09	do.	do.	do.	141·32	— 6·38
July ...	443·21	361·38	do.	250·86	141·44	— 6·30
August ...	443·31	do.	do.	do.	141·54	— 6·23
September.	443·35	do.	do.	do.	141·58	— 6·20
October ...	443·37	do.	do.	do.	141·60	— 6·19
November.	443·41	362·76	do.	252·24	141·64	— 6·16
December .	443·43	do.	do.	do.	141·66	— 6·15

1937	Note circulation	Securities in the reserve			Coin in vault	Surplus + or deficit — coin reserve
		Total	Rupee	Ster- ling		
January ...	443·45	362·77	110·52	252·25	141·68	— 6·18
February...	443·49	do.	do.	do.	141·72	— 6·11
March ...	463·45	do.	do.	do.	141·68	— 12·80
April ...	463·49	do.	do.	do.	141·72	— 12·78
May ...	463·67	383·25	do.	272·73	141·90	— 12·66
June ...	463·85	do.	do.	do.	142·08	— 12·54
July ...	463·91	do.	do.	do.	142·14	— 12·50
August ...	do.	383·69	do.	273·17	do.	do.
September.	483·89	do.	do.	do.	142·12	— 19·18
October ...	483·95	386·02	do.	275·50	142·18	— 19·14
November.	484·01	do.	do.	do.	142·24	— 19·10
December .	484·13	406·34	do.	295·82	142·36	— 19·02
1938						
January ...	484·45	406·34	110·52	296·02	142·68	— 18·80
February...	484·51	do.	do.	do.	142·74	— 18·76
March ...	484·61	406·80	108·19	298·61	142·84	— 18·70
April ...	484·93	407·37	101·86	299·18	143·16	— 18·48
May ...	485·07	do.	do.	272·73	143·30	— 19·79
June ...	485·35	do.	do.	do.	143·58	— 18·20
July ...	485·41	do.	do.	do.	143·64	— 18·16
August ...	485·61	426·03	40·84	273·17	143·84	— 18·03
September.	450·81	398·34	16·90	do.	144·04	— 6·23
October ...	450·93	402·08	2·75	275·50	144·16	— 6·15
November.	451·03	do.	do.	do.	144·26	— 6·08
December .	451·09	402·85	Nil	295·82	144·32	— 6·04
1939						
January ...	451·30	402·85	Nil	402·85	144·53	— 5·90
February...	451·33	do.	Nil	do.	144·56	— 5·88
March ...	451·39	do.	Nil	do.	144·62	— 5·84
April ...	451·51	do.	Nil	do.	144·74	— 5·76
May ...	451·55	do.	Nil	do.	144·78	— 5·74
June ...	451·75	do.	Nil	do.	144·98	— 5·60
July ...	451·93	402·90	Nil	402·90	145·16	— 5·48
August ...	452·07	do.	Nil	do.	145·30	— 5·39
September.	491·61	do.	Nil	do.	144·84 ¹	— 19·03
October ...	491·79	422·77	19·87	do.	145·02 ²	— 18·91
November.	511·99	443·61	68·65	394·96	145·22 ³	— 25·44
December .	532·09	462·90	103·21	359·69	145·32 ⁴	— 32·04

¹ Cash at call, Madras, Rs. 40·00.³ Cash at call, Madras, Rs. 20·23.² " " Rs. 20·13.⁴ " " " "

1940	Note circulation	Securities in the reserve			Coin in vault	Surplus + or deficit — coin reserve
		Total	Rupee	Ster- ling		
January ...	532·09	462·30	136·13	326·17	145·32 ¹	— 32·04
February...	512·21	462·85	149·48	313·37	145·44	— 15·30
March ...	532·79	482·76	169·39	do.	146·02 ²	— 31·58
April ...	532·87	do.	do.	do.	146·10 ³	— 31·52
May ...	552·91	do.	do.	do.	146·14 ⁴	— 38·16

¹ Cash at call, Madras, Rs. 20·23.

² " " Rs. 0·09.

³ " " "

⁴ " " Rs. 20·09.

APPENDIX II

AN ORDINANCE TO PROVIDE FOR THE REGULATION OF THE CURRENCY OF CEYLON

BE it enacted by the Governor of Ceylon, with the advice and consent of the State Council thereof, as follows :—

Short Title and Date of Operation

1. This Ordinance may be cited as the Currency Ordinance, No. of 1939, and shall come into operation on such date as may be appointed by the Governor by Proclamation published in the Gazette.

Board of Commissioners of Currency

2. (1) A Board to be called the Board of Commissioners of Currency (hereinafter referred to as the 'Board') is hereby established for the purposes of this Ordinance.

(2) The Board shall consist of five Commissioners. Three of the Commissioners shall be the persons for the time being lawfully discharging the functions of Financial Secretary, Deputy Chief Secretary and Deputy Financial Secretary. Two of the Commissioners (hereinafter referred to as 'the nominated Commissioners') shall be appointed by the Governor after consultation with the Board of Ministers. The nominated Commissioners shall hold office for three years from the date of appointment, and they shall be entitled to such remuneration for their services as may be fixed by the Governor.

(3) The Financial Secretary shall be the Chairman of the Board, and shall preside at all meetings of the Board. In the absence of the Financial Secretary the Deputy Financial Secretary shall act as Chairman.

(4) The Board shall meet whenever convened by the Chairman. The quorum at any meeting shall be three. The

Chairman shall in the event of an equality of votes have a second or casting vote.

(5) The Board shall have an office in Colombo, and may from time to time—

(a) with the approval of the Governor appoint such agents as they may consider necessary;

(b) employ such officers, servants, and other persons as they may consider necessary.

(6) The Board may arrange with the Government to employ on the work of the Board, on such terms as the Governor may determine either generally or specially, such officers and servants in the service of Government as they deem necessary, and such officers or servants shall, while engaged in the work of the Board, continue to be subject to all terms and conditions of service, all general orders, public service and pension regulations as are applicable to persons in the service of Government.

(7) Any duty devolving, and any power conferred, on the Board may be discharged or exercised by any three of the Commissioners.

(8) Any act of the Board may be signified in writing under the hand of the Chairman of the Board.

(9) If any Commissioner is for the time being unable to act the Governor may appoint a fit person to act in his place during such inability.

Standard Unit of Value

3. (1) The standard unit of value of this Island shall be the Ceylon rupee.

(2) The Ceylon rupee shall be divided into one hundred units, each of which shall be called a cent.

Currency in which Contracts may be made

4. Every contract, sale, payment, bill, note, instrument, and security for money, and every transaction, dealing, matter and thing whatsoever relating to money, or involving the payment of money, or the liability to pay any money, shall, in the

absence of express agreement to the country, be held to be made, executed, entered into, done and had in the Island according to the Ceylon rupee.

Power to Issue Currency Notes and Coins

5. (1) Subject to the provisions of this Ordinance it shall be lawful for the Board to provide, issue, and re-issue currency notes and coins.

(2) Currency notes may be issued, re-issued, cancelled or destroyed in such manner as the Board may determine.

(3) Coins may be issued, re-issued, and withdrawn from circulation in such manner as the Board may determine.

Existing Notes and Coins to Continue to be Legal Tender

6. All Ceylon notes and all Ceylon coins which are legal tender in Ceylon on the appointed date shall continue to be legal tender as provided in section 8 and shall be deemed for the purposes of this Ordinance to be issued under this Ordinance.

Currency Notes to be Issued in the Name of the Government of Ceylon

7. Currency notes issued under this Ordinance shall be issued in the name of the Government of Ceylon.

Amount for which Currency Notes and Ceylon Coins are Legal Tender

8. (1) Currency notes issued or deemed to be issued under this Ordinance shall be legal tender in Ceylon for the payment of any amount.

(2) Coins issued or deemed to be issued under this Ordinance shall, provided such coins have not been illegally dealt with, be legal tender in Ceylon for the payment of an amount not exceeding—

(a) five rupees in the case of silver coins;

(b) one rupee in the case of other coins.

Indian Rupee, &c., to be Legal Tender until Date to be Appointed

9. The following silver coins—

- (a) the Indian rupee,
- (b) the Indian half-rupee,
- (c) the Indian quarter-rupee,

shall, until such date as may be appointed by the Governor by Proclamation published in the Gazette, continue to be legal tender in Ceylon:

Provided that no coin which—

- (a) has been illegally dealt with, or
- (b) is below the weight prescribed in section 10, shall be legal tender.

Indian Rupee, &c., to be Accepted by the Board in Exchange for Ceylon Notes.

10. Until the date appointed under section 9, the Board shall accept Indian silver rupees, half-rupees and quarter-rupees in exchange for Ceylon notes and Ceylon coins at the rate of one Indian rupee for one Ceylon rupee:

Provided that such coins have not been illegally dealt with or become diminished in weight by wear or otherwise so as to be below the standard weight (if any) by more than—

- (i) six and one quarter per centum in the case of the Indian rupee,
- (ii) twelve and one half per centum in the case of the Indian half-rupee and quarter-rupee.

Meaning of 'illegally dealt with'

11. For the purposes of this Ordinance, a coin shall be deemed to be illegally dealt with—

- (a) where the coin is impaired, diminished, or lightened otherwise than by fair wear and tear, or
- (b) where the coin is defaced by gilding or silvering or by having any name, word, device, or number, stamped thereon, whether the coin has or has not been thereby diminished or lightened.

Form and Design of Currency Notes

12. (1) Currency notes issued under this Ordinance shall be—

- (a) of such denomination;
- (b) of such form and design;
- (c) printed from such plates;
- (d) printed on such paper; and
- (e) authenticated in such manner,

as may from time to time be approved by the Secretary of State.

(2) The plates shall be prepared and kept, and the notes printed, in accordance with the conditions prescribed.

Form and Design of Coins

13. (1) Coins issued under this Ordinance shall be—

- (a) of such denomination,
- (b) of such metal,
- (c) of such form and design, and
- (d) of such standard weight and fineness,

as the Governor may, with the previous approval of the Secretary of State, from time to time declare by Proclamation published in the Gazette.

(2) The Governor may also, with the previous approval of the Secretary of State, from time to time declare by Proclamation published in the Gazette the amount of remedy or variation from the standard weight and fineness which shall be allowed in the making of coins issued under this Ordinance.

*Redemption of Ceylon Currency in Indian Currency and
Issue of Ceylon Currency in Exchange for
Indian Currency*

14. Subject to the provisions of sections 16 and 17, the Board shall—

- (a) pay Indian currency at Bombay to any person who shall pay or cause to be paid to the Board in Colombo the equivalent value in Ceylon currency of the Indian currency required at the rate of one Ceylon rupee to one Indian rupee;

- (b) issue Ceylon currency in Colombo to any person who shall pay or cause to be paid to the Reserve Bank at Bombay the equivalent value in Indian currency of the Ceylon currency required at the rate of one Indian rupee to one Ceylon rupee :

Provided that the Governor may with the concurrence of the Board of Ministers by order in writing suspend the obligation to issue Ceylon currency in exchange for Indian currency.

Redemption of Ceylon Currency in Sterling and Issue of Ceylon Currency in Exchange for Sterling

15. Whenever the obligation to issue Ceylon currency in exchange for Indian currency is suspended the Board shall, subject to the provisions of sections 16 and 17—

- (a) pay sterling at London to any person who shall pay or cause to be paid to the Board in Colombo the equivalent value in Ceylon currency of the sterling required at the rate of one Ceylon rupee to one shilling and six pence;
- (b) issue Ceylon currency in Colombo to any person who shall pay or cause to be paid to the Crown Agents at London the equivalent value in sterling of the Ceylon currency required at the rate of one shilling and six pence to one Ceylon rupee.

Minimum Amount that can be Exchanged

16. The Board shall not exchange currency as hereinbefore provided unless the amount of the Ceylon currency to be given or received in exchange is not less than the prescribed minimum sum.

Charges in respect of Exchange

17. The Board shall be entitled to charge and levy from any person exchanging currency as hereinbefore provided—

- (a) a commission at a rate or rates to be prescribed from time to time not exceeding one rupee and seventy-five

cents for every one hundred rupees of Ceylon currency taken or given in exchange;

- (b) a charge for all telegraphic communications between the Board and its agents in connexion with the exchange calculated at the usual rates prescribed for the public.

Demonetisation of Notes and Coins

18. (1) The Governor may by Proclamation published in the Gazette declare that any currency notes or Ceylon coins issued or deemed to be issued under this Ordinance shall cease to be legal tender after a date to be specified in such Proclamation.

(2) The holder of any currency note demonetized under sub-section (1) shall, on tendering such currency note at the office of the Board in Colombo at any time after the date specified in the Proclamation, be entitled to receive legal tender in exchange.

Establishment of Currency Security Fund

19. A fund to be called the Currency Security Fund (hereinafter referred to as 'the Security Fund') is hereby established.

Transfer of Moneys and Investments of the Ceylon Currency Commissioners to the Security Fund

20. All moneys and investments in the possession of or standing to the credit of the Ceylon Currency Commissioners under the Ceylon Paper Currency Ordinance, 1884, are hereby transferred to the Security Fund:

Provided that if on the appointed date the total value of such moneys and investments together with the remainder of the Security Fund exceeds the face value—

(a) of all currency notes in circulation; and

(b) of all coins estimated by the Board to be in circulation, the excess shall be paid by the Board to the general revenue.

Crediting of Certain Receipts to the Security Fund

21. The Board shall credit to the Security Fund—
- (a) the Indian currency and sterling received on behalf of the Board under sections 14 and 15 by the Reserve Bank and the Crown Agents respectively;
 - (b) proceeds of sale of silver;
 - (c) the Indian silver rupees, half-rupees, and quarter-rupees accepted by the Board under section 10;
 - (d) each year, subject to section 33 (2), a sum equal to one per centum of the amount of the Security Fund.

Charges upon the Security Fund

22. There shall be charged upon the Security Fund—
- (a) the Indian currency and sterling paid out on behalf of the Board by the Reserve Bank and the Crown Agents respectively, under the provisions of sections 14 and 15;
 - (b) the purchase price of silver purchased for the manufacture of coins;
 - (c) all expenses incurred in the purchase or disposal of investments, or in the remittance of money forming part of the Security Fund.

Crown Agents and Reserve Bank to hold Security Fund

23. (1) The Security Fund shall be held—
- (a) by the Reserve Bank, or
 - (b) by the Crown Agents, or
 - (c) partly by the Reserve Bank and partly by the Crown Agents :

Provided that the Board may hold in Colombo that part of the Security Fund referred to in paragraphs (c) and (d) (ii.) of section 31.

(2) The Board shall from time to time determine what amount of the Security Fund shall be held by the Crown Agents and the Reserve Bank respectively.

(3) Such proportion of the Security Fund as may be determined by the Board with the prior approval of the Governor shall ordinarily be held in liquid form. When such liquid part

of the Security Fund falls below the proportion determined under this sub-section the Board shall as soon as conveniently may be direct either the Crown Agents or the Reserve Bank or both to sell securities forming part of the Security Fund in order to restore the liquid part of the Fund to the said proportion.

(4) The Board may from time to time, with the prior approval of the Governor, alter the proportion determined under sub-section (3).

- (5) (a) The liquid portion of the Security Fund may be—
- (i) held at London or Bombay in cash or on deposit, or
 - (ii) lent at London or Bombay at call or for short terms, or
 - (iii) invested at London or Bombay in readily realizable securities.

(b) The Crown Agents and the Reserve Bank shall in all matters affecting the said portion of the Security Fund be bound by such general directions as may be given by the Board with the prior approval of the Governor.

(6) Subject to the provisions of sub-section (3) and subject to such general directions as may be given by the Board with the prior approval of the Governor and the Secretary of State, the Crown Agents and the Reserve Bank may—

(a) invest the Security Fund—

- (i) in securities of the Government of any part of the British dominions, other than the Government of Ceylon;
- (ii) in securities guaranteed by the Government of any part of the British dominions other than the Government of Ceylon; or
- (iii) in any other securities approved by the Secretary of State;

(b) sell securities and, subject to the provisions of paragraph (a), invest the proceeds in other securities.

Board may Borrow on Security of Investments

24. Whenever the amount of the liquid portion of the Security Fund shall be insufficient to meet payments falling

due under sections 14 and 15, it shall be lawful for the Board to authorise the Crown Agents or the Reserve Bank, as the case may be, to borrow or to advance on the security of any of the investments of the Board such sums as may be necessary for meeting any of the payments so falling due:

Provided that any sum so borrowed or advanced shall be repaid within a period of one year.

Currency Income Account

25. An account to be called the Currency Income Account (hereinafter referred to as the 'Income Account') is hereby established.

What Sums may be Credited to Income Account.

26. The Board shall credit to the Income Account—

- (a) all dividends, interest, or other income derived from—
 - (i) investments, or
 - (ii) the employment in any other manner of the moneys of the Security Fund;
- (b) all commissions paid to the Board in respect of dealings in currency as provided hereinbefore;
- (c) all other receipts of the Board which by this Ordinance are not required to be paid to the Security Fund.

Charges upon Income Account

27. There shall be charged upon the Income Account—

- (a) all outgoings and expenses of the Board and its agents including the Crown Agents and the Reserve Bank which by this Ordinance are not charged on the Security Fund;
- (b) each year, subject to section 33 (2), a sum equal to one per centum of the amount of the Security Fund.

When Expenditure of an Exceptional Nature may be Charged upon the Security Fund

28. The Board may, with the prior approval of the Governor, charge any expenditure of an exceptional nature on

currency matters upon the Security Fund and not upon the Income Account.

*Surplus in Income Account to be Used to Meet Deficiency
in Security Fund*

29. (1) If on the thirtieth day of September in any year the face value—

(a) of all currency notes in circulation, and

(b) of all Ceylon coins estimated by the Board to be in circulation,

exceeds the amount of the Security Fund, there shall be transferred to the said Fund the surplus (if any) in the Income Account or such part thereof as shall be equal to the excess.

(2) The whole of the surplus in the Income Account or any part thereof which shall not be required under sub-section (1) shall be paid into the general revenue of the Island.

*Deficiency in Income Account to be Met from the
General Revenue*

30. If on the thirtieth day of September in any year there is a deficiency in the Income Account, it shall be lawful for the Governor, and he is hereby required on the application of the Board, to order the payment of a sum equal to such deficiency to the Income Account out of the general revenue of the Island.

Amount of Security Fund How Determined

31. For the purposes of this Ordinance the Security Fund at any date shall be the aggregate at that date of—

(a) the amount of the liquid moneys of the Fund;

(b) the market value, as estimated by the Board, of the investments in the Fund less the amount of any advances obtained under section 24;

(c) the realizable value of the silver held by or on behalf of the Board;

(d) the realizable value of the silver—

(i) in the Ceylon coin estimated by the Board to be in circulation,

- (ii) in the Ceylon coin held by or on behalf of the Board.

*When Governor may Order Payment out of
General Funds of the Island to meet the Legal
Obligations of the Board*

of the Island to meet the Legal Obligations of the Board

32. If at any time the Board is unable to meet its legal obligations under this Ordinance, it shall be lawful for the Governor and he is hereby required to order the payment out of the general funds of the Island of such sum as may be necessary to meet such obligations of the Board.

Procedure to be Adopted when Security Fund has Surplus

33. If on the thirtieth day of September in any year, the amount of the Security Fund exceeds one hundred and ten per centum of the face value—

(a) of all currency notes in circulation, and

(b) of all Ceylon coins estimated by the Board to be in circulation,

the Governor may, on being informed by the Board of such excess, with the approval of the Secretary of State, give either or both of the following directions:—

(1) that the whole or any part of such excess shall be paid from the said Fund to the general revenue of the Island;

(2) that the annual charge on the Income Account of one per centum of the Security Fund shall be wholly or partially discontinued till such time as he may order otherwise.

Publication of Statements

34. (1) The Board shall—

(a) cause to be published yearly in the Gazette as soon as may be an abstract showing as at the thirtieth day of September—

(i) the face value of all currency notes in circulation;

- (ii) the face value of the Ceylon coin estimated by the Board to be in circulation;
 - (iii) a list of the securities held by the Security Fund showing in each case the nominal value, the cost price and the latest known market price;
 - (iv) the amount of the liquid moneys of the Security Fund;
 - (v) the realizable value of the silver held by or on behalf of the Board;
 - (vi) the realizable value of the silver in the Ceylon coins estimated by the Board to be in circulation;
 - (vii) the realizable value of the silver in the Ceylon coins held by or on behalf of the Board; and
 - (viii) the total amount of the Security Fund;
- (b) submit annually to the Governor and the Secretary of State a statement of the transactions during the previous year.
- (2) The accounts of all transactions of the Board shall be audited by the Auditor-General.

*Vesting of Rights, Powers, Duties, Obligations, and
Contracts of the Ceylon Currency Commissioners
in the Board*

35. On and after the appointed date—

- (a) all debts, liabilities, obligations, or contracts of the Ceylon Currency Commissioners outstanding or subsisting on such date shall be deemed to be debts, liabilities, obligations, or contracts of the Board;
- (b) all deeds, bonds, securities, and other instruments executed or issued by or on behalf of or in favour of the Ceylon Currency Commissioners and in force or enforceable on such date shall be deemed to be executed or issued by or on behalf of or in favour of the Board;
- (c) all acts, duties, and functions of the Ceylon Currency

Commissioners remaining unfinished or uncompleted on such date shall be continued and completed by the Board.

Regulations

36. The Governor may, with the approval of the Secretary of State, make regulations—

- (a) prescribing anything which by this Ordinance is to be prescribed;
- (b) prescribing the conditions upon which and the manner in which coin which is legal tender in Ceylon may be accepted by the Board in exchange for currency notes; and
- (c) generally for the better carrying into effect of the provisions of this Ordinance.

Evidence

37. (1) In any proceedings in which the genuineness of any currency note shall be in question, a certificate under the hand of the Deputy Financial Secretary to the effect that such note is spurious on the ground that it does not contain the secret features characteristic of a genuine note of corresponding denomination, number and date, shall be received in all courts of law as conclusive evidence of the spuriousness of such note.

(2) The Deputy Financial Secretary shall not be examined or cross-examined with respect to any such certificate.

(3) The certificate shall be in the form following:—

This is to certify that I have personally examined the document shown to me, and marked _____, purporting to be a currency note of the following denomination, number and date, namely—

Denomination :

Number :

Date :

and that the said note is spurious on the ground that it does not contain the secret features characteristic of a

genuine note of corresponding denomination, number and date.

Penalty for Mutilating or Defacing a Currency Note

38. Whoever, without the authority of the Board—

- (a) cuts, or perforates any currency note,
- (b) writes, prints, draws, or affixes any seal or stamp on the face or reverse of any currency note,
- (c) attaches or affixes to any currency note anything in the nature or form of an advertisement,

shall be guilty of an offence and shall, on conviction after summary trial by a Magistrate, be liable to a fine not exceeding one hundred rupees.

*Power to Issue Currency Notes Remaining
Unissued on the Appointed Date*

39. The Board is hereby empowered to issue any currency notes printed under the authority of the Ceylon Currency Commissioners constituted under the Paper Currency Ordinance (Chapter 291), and remaining unissued on the appointed date.

The currency notes so issued shall be deemed for all purposes to be currency notes issued under this Ordinance.

Interpretation

40. In this Ordinance, unless the context otherwise requires—

‘appointed date’ means the date on which this Ordinance comes into operation;

‘Crown Agents’ means the person or persons for the time being acting as the Crown Agents for the Colonies in England;

‘currency notes in circulation’ means all currency notes issued or deemed to be issued under this Ordinance excluding all currency notes cancelled, destroyed, demonetized and in the hands of the Board;

‘Reserve Bank’ means the Reserve Bank of India;

‘Secretary of State’ means one of His Majesty’s Principal Secretaries of State.

Repeal

41. The Paper Currency Ordinance (Chapter 291) is hereby repealed.

OBJECTS AND REASONS

The scheme of the existing Ordinance for the regulation of the currency of the Island is unsuited to modern conditions; further, it involves the maintenance of a considerable reserve in Indian silver rupees, which is uneconomic.

The object of this Bill is to provide for the economic handling of the Island's currency on up-to-date lines. Provision is made for a new standard unit of value to be called the Ceylon rupee.

Colombo, July 31, 1939.

H. J. HUXHAM,
Financial Secretary.

APPENDIX III

EXCHANGE CONTROL REGULATIONS

NOTE:—

THESE regulations are made by His Excellency the Governor by virtue of the powers vested in him by section 1 of the Emergency Powers (Defence) Act, 1939, of the Imperial Parliament as applied to Ceylon by the Emergency Powers (Colonial Defence) Order in Council, 1939, and the Emergency Powers (Colonial Defence) (Amendment) Order in Council, 1940. They are inter-related and complementary to the exchange control systems in other parts of the Empire. Their primary object is to prevent the export of capital, which might weaken the exchanges, and to conserve the exchange resources of the country in order to help the Empire to pay for essential imports from outside the sterling circle.¹ They form a part of the Island's war effort.

To facilitate exchange control the regulations (Finance) restrict all dealings in exchange involving currencies of countries outside the sterling circle (which we shall call scheduled currencies) to authorized banks in Ceylon.² No individual can purchase such currencies without a permit nor can securities or other monetary assets be sent out of Ceylon except under permit. The regulations provide for the compulsory sale to the Controller of Exchange or a person designated by him of certain specified currencies³ and of any gold coin or bullion in the possession of Ceylon residents.

¹ The sterling circle comprises the countries of the British Empire, except Canada, Newfoundland and Hong Kong, any territory in respect of which a mandate on behalf of the League of Nations has been accepted by any of the Empire countries, any British protectorate or protected State, Egypt, the Anglo-Egyptian Sudan, Iraq and Belgian Congo.

² The authorized banks are the exchange banks, the Imperial Bank of India, and the Bank of Ceylon.

³ The term 'currencies' includes bank or currency notes, bank balances, and any other means of payment such as bills of exchange and cheques expressed in scheduled currencies. See *Explanatory Leaflet No. 2* (Revised up to 10-1-1941) issued by the office of the Controller of Exchange, Colombo.

In order to ensure that Ceylon residents did not acquire scheduled currencies without their being available to the Government, the (Finance No. 2) regulations lay it down that exports from the Island to certain specified countries outside the sterling circle can be made only under the authority of a licence. As foreign currency earnings from exports must be conserved for the purchase of materials of war and other requirements of the fighting services, claims for such currencies must be reduced to the smallest magnitude consistent with the efficient running of the economic life of the country. Imports of all kinds into the Island are, therefore, subjected to careful scrutiny and control by the (Control of Imports) regulations. Purchases from outside the sterling circle are restricted to absolute necessities which are not procurable within the circle. The licensing of imports and exports also enables prevention of any attempt at trading with the enemy countries and makes possible the most advantageous use of shipping space, which needs to be economized.

After the fall of France and Belgium considerable quantities of British bank notes, chiefly Bank of England notes, fell into the hands of Germany. Securities payable in Empire currencies were also seized from the occupied territories. As a precautionary measure to frustrate the attempt of the enemy to realize the securities, and to procure against their proceeds and the bank notes, essential supplies from neutral countries, which latter might obtain their value from the Empire countries, in unison with similar measures adopted in other parts of the Empire, transfer of securities from residents outside the sterling circle to residents in Ceylon are altogether prohibited and the importation of notes issued by banks in Great Britain and Northern Ireland is subjected to rigid restrictions and careful scrutiny of source.

With a view to closing the loop-holes in the exchange restrictions, the United Kingdom Control introduced in July 1940 more stringent orders with regard to the transfer of sterling balances held by residents outside the sterling circle. The "free" sterling markets in the neutral countries obtained their supply of sterling from the sterling balances held in the United Kingdom by residents outside the sterling circle. Sterling from the

“free” markets, which was sold at a rate more advantageous than the British official rate, was bought by foreigners to pay for imports of British goods invoiced in sterling, freights and insurance premiums payable in sterling, interest or dividends on British sterling investments overseas, repayment of capital, etc.¹ The net result of this was a corresponding loss of foreign exchange by the authorities, as, if sterling was not available in the “free” markets, payments owing to the United Kingdom would have been made in foreign currencies at the official buying rates for them. The new orders are meant to curtail or dry up the supply of sterling to the “free” markets.

• Transfers of sterling as between residents outside the sterling circle *inter se* and between residents and non-residents are canalised into separate accounts, which are mutually unconnected and run parallel to one another. Agreements have been entered into with certain countries² whereby all proceeds of exports from them to Great Britain will be credited to separate Special Accounts of these countries with banks in Great Britain. Payments for British goods imported into these countries must be made by acquiring sterling from these accounts at the official rate. In the case of the United States and Switzerland (the two remaining countries on a free exchange basis), as a result of negotiations with the banks in the two countries, payments for imports from them are credited to Registered Accounts with banks in Great Britain and payments for British goods imported into the two countries is debited to the Registered Accounts. At the end of a given period the account is settled in gold. This feature distinguishes Registered Accounts from Special Accounts. Similarly debits and credits arising out of certain payments of a personal nature (salaries, pensions, insurance premiums, rent, etc.) in the case of certain specified countries, are canalised in

¹ See Paul Einzig, ‘The Unofficial Market in Sterling’, *Economic Journal*, December 1939, p. 674.

² Special Account agreements are now concluded with the Argentine, Bolivia, Brazil, Chile, Greece, Hungary, Paraguay, Peru, Portugal and the Portuguese Colonies, Roumania, Spain, and Turkey. See *Explanatory Leaflet No. 1* (Revised up to 27-1-1941).

special accounts (e.g. Sterling Area Accounts maintained by residents of the dollar area, Switzerland, the Argentine, Brazil, etc.). Similar accounts are opened to serve the requirements of sterling payments owing to and from non-sterling countries of the Empire (Canada and Newfoundland).

In this manner the exchange transactions through the official channel are sought to be increased at the expense of the "free" markets in sterling. After the extension of payments agreements to all neutral countries, as payments from one account to another are not permitted, it is expected that the supply of "free" sterling and, therefore, the "free" sterling markets themselves will dry up in one country after another.¹

I give below a summary of the more important regulations.

DEFENCE (FINANCE) REGULATIONS

Except with the permission granted by or on behalf of the Governor, none but banks authorized in that regard shall deal in any scheduled currency or gold. Subject to certain exemptions, except with the permission of the Governor, no gold, currency, or monetary assets of any kind (bank note, money-order, etc.), shall be taken or sent out of Ceylon, nor shall any Ceylon resident, except on permit, draw, issue or negotiate any bill of exchange or acknowledge any debt so that a right to receive a payment in Ceylon is created or transferred in favour of a resident outside the sterling area, or make any payment to any such person.

Permits are normally granted to cover exchange necessary for the purpose of meeting reasonable requirements of a trade or business carried on in Ceylon, for performing contracts entered into before September 3, 1939, or for defraying reasonable travelling or other personal expenses.

Exemptions from the operation of these regulations are permissible for the taking or sending out of Ceylon of bills of exchange payable in currencies of the sterling circle, the taking or sending to British India, in currency, of Rs. 500

¹ For a criticism of the new orders see Paul Einzig, 'Exchange Control At Last?', *The Banker*, August 1940.

on any one day, the taking out of Ceylon of Rs. 200 or its equivalent for personal travelling expenses and the taking or sending out of Ceylon of money orders payable in currencies of the Empire sterling circle to places in the Empire other than Canada, Newfoundland and Hong Kong.¹

Payments for imports from Special Accounts countries² can only be made by a transfer of sterling to a Special Account of the country concerned in the United Kingdom. Payments for imports from the United States and Switzerland, if not made in dollars or Swiss francs acquired through the Control, must be made by transfer of sterling to a Registered Account of the United States or Switzerland. Similarly payments for imports from Canada and Newfoundland, if not made in Canadian dollars, can only be made by transferring sterling to a Canadian Authorized Account in the United Kingdom.

DEFENCE (FINANCE NO. 2) REGULATIONS

It is incumbent on everyone resident in Ceylon who has the power to sell, procure the sale of, assign, or procure the assignment of the currencies of certain specified countries³ to offer such currencies to the Controller of Exchange through his bank. Payment will be made for them in Ceylon currency at rates determined by the Controller.

No goods of any kind shall be exported from Ceylon to certain territories⁴ except on licence which, subject to any pre-zero exemptions, will only be granted on condition that payment

¹ For other exemptions see *Ceylon Government Gazette Extraordinary* No. 8694 of December 12, 1940.

² See footnote 2 on p. 281 above.

³ Argentine pesos, Belgian Congo francs, Canadian dollars, Escudos, Netherlands East Indies guilders, Netherlands West Indies guilders, Newfoundland dollars, Panamanian dollars, Philippine pesos, Swedish kronor, Swiss francs, and United States dollars.

⁴ The Argentine Republic, Brazil, the non-enemy French territories other than Syria and Laburnum, Hungary, Portugal and the Portuguese Colonies, Roumania, Sweden, Switzerland, the U.S.A., the Philippine Islands and all territories under the sovereignty of the U.S.A., Uruguay, Peru, Greece, Bolivia, Chile, Paraguay, Turkey and Spain.

for such goods will be made in the currency and by the method prescribed by the Controller of Exchange; and where payment for such goods is to be made in scheduled currencies, that arrangements have been made to surrender it either to the Treasury in the United Kingdom or to an authorized bank in Ceylon for the equivalent of such currency in sterling in the United Kingdom or in rupees in Ceylon.

DEFENCE (FINANCE NO. 3) REGULATIONS

Subject to the following exemptions, no person shall import or bring into Ceylon any bank notes issued by banks in the United Kingdom¹ except with the permission of the Controller of Exchange.

Exemption from this regulation is permissible in cases where the bank note (a) is imported from India, (b) is brought by a passenger or a member of the crew of any ship, or (c) by any member of His Majesty's Regular Naval, Military and Air Forces in Ceylon. In case (b) the Controller of Exchange must be satisfied that the note does not come from any of the 'tainted' territories in the East² and that the amount brought in does not exceed the requirements of reasonable personal expenditure of the individual.

DEFENCE (GOLD COIN AND BULLION) REGULATIONS

Every resident in Ceylon who has the power to sell, or procure the sale of any gold shall offer that gold to the Controller of Exchange at such price in Ceylon currency as the Controller may determine.

¹ These regulations apply to the bank notes issued by the following banks :— (i) The Bank of England. (ii) The following banks in Scotland :— (a) The Bank of Scotland. (b) The Royal Bank of Scotland. (c) The British Linen Bank. (d) The Commercial Bank of Scotland. (e) The National Bank of Scotland. (f) The Union Bank of Scotland. (g) The North of Scotland Bank. (h) The Clydesdale Bank. (iii) The following banks in Northern Ireland :—(a) The Bank of Ireland. (b) The Provincial Bank of Ireland. (c) The Belfast Banking Co. (d) The Northern Bank. (e) The Ulster Bank. (f) The National Bank.

² Arabia, Iran, Iraq, any port on the Persian Gulf, or any of the Portuguese territories in India.

The Controller may grant exemptions from these regulations for good reasons shown, e.g. that the persons interested in the gold are not resident in Ceylon; that it is required to meet a contract entered into before the date of publication of the regulation (September 28, 1939); or that it is required for meeting the reasonable requirements of industry.

DEFENCE (CONTROL OF IMPORTS) REGULATIONS

For the purposes of these regulations articles of import into the Island have been divided into four categories.¹ Goods in category A,² which are mainly un-necessary, are altogether prohibited from being imported into Ceylon from any country whatsoever. To this group belong gold coin and bullion, sparkling wines other than champagne, fireworks, firearms of certain description, stationery compendiums, straw, grass and rush mats, articles of solid gold or silver other than jewellery, monkeys, perfumed spirits with certain exceptions, and automatic machines operated by coins.

A second category of goods (Category B),³ the bulk of which are normally imported from the Empire, are prohibited from being imported into Ceylon if they originate from certain specified territories.⁴ The importation of another category of goods (Category C)⁵ is regulated by licence if they originate from these countries. Silver bullion is put in a class by itself (Category D)⁶

¹ To these have now been added a fifth category (Category E) comprising certain specified classes of food-stuffs imported from Great Britain. Importation of these articles is subject to licence. The primary object of such licensing, however, is to prevent any drain of the essential food supply of Great Britain. See *Explanatory Leaflet No. 4*.

² For the contents of this category see *Explanatory Leaflet No. 3* (Revised up to 11-12-1940), p. 3.

³ *Ibid.*, pp. 3-6.

⁴ Canada, Palestine, Trans-Jordan and any territory or place not forming part of the British Empire and not being enemy territory within the meaning of the Defence (Trading with the Enemy) Regulations, 1939.

⁵ *Explanatory Leaflet No. 3* loc. cit., pp. 6-8.

⁶ *Ibid.*, p. 8.

and its importation is regulated by licence from any country whatsoever.

DEFENCE (CONTROL OF EXPORTS) REGULATIONS

Subject to the following exemptions, no commodity shall be exported or re-exported from Ceylon to any country not forming part of the British Empire or to any destination involving transit through such territories, except on licence.

Exemptions from these regulations are permissible in respect of cargo transhipped here on a through bill of lading, ships' stores, articles taken by passengers for their personal use, certain specified articles¹ not exceeding 5 lbs. in weight and any others not exceeding 20 lbs. in weight despatched by post.

DEFENCE (SECURITIES) REGULATIONS

Subject to any exemptions allowed by the Governor no person shall, except with the Governor's permission sell, transfer, or do anything which involves the creation of a charge on certain specified classes of securities,² which are likely to have a market outside the sterling area.

The owners of such securities shall make a return to the Controller of Exchange giving particulars which he may require. If the Governor thinks it desirable for the purpose of strengthening the financial position of Ceylon, he may compulsorily acquire these securities from their owners at a price not lower than the prevailing market price. These regulations will not apply to cases where all persons interested in the securities were not resident in Ceylon since March 29, 1940.

No resident in Ceylon shall (1) transfer any rupee or sterling securities from a register in Ceylon to a register outside the

¹ Arecanuts, cinnamon, cinnamon oil, cloves, clove oil, coffee, coir fibre, nutmegs, pepper, plumbago, or rubber.

² The securities affected by these regulations are those the principal, interest or dividend on which are payable in the currency of the following countries:—Argentina, Belgium, Belgian Congo, Canada, France, Holland, Netherlands East Indies, Netherlands West Indies, Newfoundland, Norway, Panama, Philippine Islands, Portugal, Sweden, Switzerland, and the United States of America.

sterling area; (2) exchange securities in Ceylon for securities outside the sterling area; or, without the permission of the Control, (3) transfer such securities to any resident outside the sterling area or (4) to another resident in Ceylon. In case (4) permission will not be granted unless the Control is satisfied that no resident outside the sterling area had, immediately before the transfer, any interest in the securities. In case (3) permission will be granted only if the Control is satisfied that the security is purchased for its full value, that payment is made in sterling belonging to a resident outside the sterling circle and that, since September 3, 1939, no enemy has directly or indirectly had any interest in the securities.

Transfers of sterling or rupee securities from residents outside the sterling circle to residents in Ceylon is altogether forbidden.

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